

# ADVANCED ENERGY INDUSTRIES INC

## FORM 10-Q (Quarterly Report)

Filed 11/13/2001 For Period Ending 9/30/2001

Address	1625 SHARP POINT DR FT COLLINS, Colorado 80525
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CIK	0000927003
Industry	Electronic Instr. & Controls
Sector	Technology
Fiscal Year	12/31

# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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## FORM 10-Q

(MARK ONE)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended September 30, 2001.

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

*Commission file number: 000-26966*

## ADVANCED ENERGY INDUSTRIES, INC.

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(Exact name of registrant as specified in its charter)

DELAWARE

84-0846841

-----  
(State or other jurisdiction  
of incorporation or organization)

-----  
(I.R.S. Employer Identification No.)

1625 SHARP POINT DRIVE, FORT COLLINS, CO

80525

-----  
(Address of principal executive offices)

-----  
(Zip Code)

Registrant's telephone number, including area code: (970) 221-4670

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐.

As of November 8, 2001, there were 31,821,175 shares of the Registrant's Common Stock, par value \$0.001 per share, outstanding.

**ADVANCED ENERGY INDUSTRIES, INC.**

**FORM 10-Q**

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# PART I FINANCIAL INFORMATION

## ITEM 1. UNAUDITED FINANCIAL STATEMENTS

### ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

	SEPTEMBER 30, 2001 (UNAUDITED) -----	DECEMBER 31, 2000 (UNAUDITED) -----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents .....	\$147,683	\$ 31,716
Marketable securities - trading .....	128,609	157,811
Accounts receivable, net .....	41,573	76,545
Income tax receivable .....	13,233	74
Inventories, net .....	46,808	45,266
Other current assets .....	3,298	2,508
Deferred income tax assets, net .....	10,044	7,483
	-----	-----
Total current assets .....	391,248	321,403
	-----	-----
PROPERTY AND EQUIPMENT, net .....	32,078	24,101
OTHER ASSETS:		
Deposits and other .....	656	995
Notes receivable .....	3,924	2,472
Goodwill and intangibles, net .....	23,915	9,890
Investments - available for sale .....	2,114	1,824
Demonstration and customer service equipment, net .....	4,509	2,889
Deferred debt issuance costs, net .....	6,084	2,261
	-----	-----
Total assets .....	\$464,528	\$365,835
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable - trade .....	\$ 12,629	\$ 18,250
Accrued payroll and employee benefits .....	7,620	11,723
Other accrued expenses .....	5,920	4,383
Customer deposits .....	461	104
Accrued income taxes payable .....	--	7,923
Current portion of capital lease obligations and long-term debt .....	66	1,337
Accrued interest payable on convertible subordinated notes .....	2,205	529
	-----	-----
Total current liabilities .....	28,901	44,249
	-----	-----
LONG-TERM LIABILITIES:		
Notes payable, net of current portion .....	230	1,043
Deferred income tax liabilities, net .....	1,093	--
Convertible subordinated notes payable .....	206,600	81,600
	-----	-----
	207,923	82,643
	-----	-----
Total liabilities .....	236,824	126,892
	-----	-----
MINORITY INTEREST .....	--	145
	-----	-----
STOCKHOLDERS' EQUITY .....	227,704	238,798
	-----	-----
Total liabilities and stockholders' equity .....	\$464,528	\$365,835
	=====	=====

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated balance sheets.



**ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS**

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	THREE MONTHS ENDED SEPTEMBER 30,	
	2001 (UNAUDITED)	2000 (UNAUDITED)
SALES .....	\$ 38,722	\$ 96,317
COST OF SALES .....	27,686	49,492
Gross profit .....	11,036	46,825
OPERATING EXPENSES:		
Research and development .....	10,967	9,711
Sales and marketing .....	5,694	6,232
General and administrative .....	4,817	6,748
Other operating expenses .....	1,221	--
Restructuring charge .....	--	1,000
Merger costs .....	--	2,250
Total operating expenses .....	22,699	25,941
(LOSS) INCOME FROM OPERATIONS .....	(11,663)	20,884
OTHER (EXPENSE) INCOME .....	(711)	5,598
Net (loss) income before income taxes and minority interest .....	(12,374)	26,482
(BENEFIT) PROVISION FOR INCOME TAXES .....	(4,704)	10,195
MINORITY INTEREST IN NET LOSS .....	(188)	(2)
NET (LOSS) INCOME .....	\$ (7,482)	\$ 16,289
BASIC (LOSS) EARNINGS PER SHARE .....	\$ (0.24)	\$ 0.52
DILUTED (LOSS) EARNINGS PER SHARE .....	\$ (0.24)	\$ 0.50
BASIC WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING .....	31,784	31,339
DILUTED WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING .....	31,784	32,417

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001 (UNAUDITED)	2000 (UNAUDITED)
SALES .....	\$ 159,607	\$ 257,046
COST OF SALES .....	109,567	131,191
Gross profit .....	50,040	125,855
OPERATING EXPENSES:		
Research and development .....	34,396	26,328
Sales and marketing .....	18,286	17,472
General and administrative .....	16,636	18,197
Other operating expenses .....	1,221	--
Goodwill impairment .....	5,446	--
Restructuring charge .....	614	1,000
Litigation recovery .....	(1,500)	--
Merger costs .....	--	4,583
Total operating expenses .....	75,099	67,580
(LOSS) INCOME FROM OPERATIONS .....	(25,059)	58,275
OTHER (EXPENSE) INCOME .....	(594)	6,449
Net (loss) income before income taxes and minority interest .....	(25,653)	64,724
(BENEFIT) PROVISION FOR INCOME TAXES .....	(8,568)	24,165
MINORITY INTEREST IN NET LOSS .....	(148)	(86)
NET (LOSS) INCOME .....	\$ (16,937)	\$ 40,645

BASIC (LOSS) EARNINGS PER SHARE .....	\$ (0.53)	\$ 1.30
	=====	=====
DILUTED (LOSS) EARNINGS PER SHARE .....	\$ (0.53)	\$ 1.25
	=====	=====
BASIC WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING .....	31,673	31,276
	=====	=====
DILUTED WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING .....	31,673	32,473
	=====	=====

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated statements.

**ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
(IN THOUSANDS)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001 (UNAUDITED)	2000 (UNAUDITED)
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income .....	\$ (16,937)	\$ 40,645
Adjustments to reconcile net (loss) income to net cash provided by operating activities --		
Depreciation and amortization .....	11,877	7,436
Amortization of deferred debt issuance costs .....	427	481
Amortization of deferred compensation .....	394	329
Minority interest .....	(148)	(86)
Stock issued for services rendered and merger costs .....	--	2,430
Provision for deferred income taxes .....	(1,740)	(2,020)
Provision for inventory and product-related liabilities .....	7,116	--
Provision for restructuring .....	614	--
Provision for bad debts .....	200	--
Impairment of goodwill .....	5,446	--
Loss (gain) on disposal of property and equipment .....	15	(55)
Gain on sale of investment .....	--	(4,841)
Earnings from marketable securities, net .....	(3,436)	(7,122)
Changes in operating assets and liabilities --		
Accounts receivable-trade, net .....	35,756	(27,204)
Related parties and other receivables .....	183	(1,898)
Inventories .....	(4,480)	(11,322)
Other current assets .....	(701)	(399)
Deposits and other .....	338	(40)
Demonstration and customer service equipment .....	(2,316)	(1,022)
Accounts payable - trade .....	(6,476)	1,707
Accrued payroll and employee benefits .....	(4,508)	4,367
Customer deposits and other accrued expenses .....	46	3,051
Income taxes payable/receivable, net .....	(19,353)	7,891
Net cash provided by operating activities .....	2,317	12,328
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Marketable securities transactions .....	33,312	(5,000)
Advances under notes receivable, net .....	(1,452)	(2,472)
Proceeds from sale of investment .....	--	4,464
Proceeds from sale of equipment .....	--	150
Purchase of property and equipment, net .....	(10,785)	(8,687)
Purchase of investments .....	(639)	(1,031)
Acquisition of Engineering Measurements Company, net of cash acquired .....	(29,932)	--
Net cash used in investing activities .....	(9,496)	(12,576)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from convertible debt, net .....	121,250	--
Net change from notes payable and capital lease obligations .....	(2,084)	24
Proceeds from common stock transactions .....	2,999	4,013
Net cash provided by financing activities .....	122,165	4,037
EFFECT OF CURRENCY TRANSLATION ON CASH .....	981	(1,578)
INCREASE IN CASH AND CASH EQUIVALENTS .....	115,967	2,211
CASH AND CASH EQUIVALENTS, beginning of period .....	31,716	21,043
CASH AND CASH EQUIVALENTS, end of period .....	\$ 147,683	\$ 23,254
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid for interest .....	\$ 2,308	\$ 3,830
Cash paid for income taxes .....	\$ 13,203	\$ 18,411

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed consolidated statements.



# ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### (1) BASIS OF PRESENTATION AND MANAGEMENT OPINION

In the opinion of management, the accompanying unaudited condensed consolidated balance sheets and statements of operations and cash flows contain all adjustments necessary to present fairly the financial position of Advanced Energy Industries, Inc., a Delaware corporation, and its wholly owned subsidiaries (the "Company") at September 30, 2001 and December 31, 2000, and the results of the Company's operations for the three- and nine-month periods ended September 30, 2001 and 2000, and cash flows for the nine-month periods ended September 30, 2001 and 2000.

The unaudited financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q and do not include all the information and note disclosures required by generally accepted accounting principles. The financial statements should be read in conjunction with the audited financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2000, filed March 27, 2001.

The preparation of the Company's condensed consolidated financial statements requires the Company's management to make certain estimates and assumptions that affect the amounts reported and disclosed in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

### (2) ACQUISITIONS

EMCO -- On January 2, 2001, Engineering Measurements Company ("EMCO"), a publicly held, Longmont, Colorado-based manufacturer of electronic and electromechanical precision instruments for measuring and controlling the flow of liquids, steam and gases, was merged with a wholly owned subsidiary of the Company. The Company paid the EMCO shareholders cash in an aggregate amount of approximately \$30 million. The acquisition was accounted for using the purchase method of accounting, and the operating results of EMCO are reflected in the accompanying condensed consolidated financial statements prospectively from the date of acquisition. The purchase price was allocated to the net assets of EMCO as summarized below:

	(In thousands)
	(UNAUDITED)
Cash and cash equivalents	\$ 459
Marketable securities	674
Accounts receivable	1,167
Inventories	1,678
Deferred income tax assets, current	584
Other current assets	88
Fixed assets	4,596
Goodwill and intangibles	23,152
Accounts payable	(355)
Accrued payroll	(405)
Other accrued expenses	(391)
Deferred income tax liability	(856)
	-----
	\$ 30,391
	=====

SEKIDENKO, INC. -- On August 18, 2000, Sekidenko, Inc. ("Sekidenko"), a privately held, Vancouver, Washington state-based supplier of optical fiber thermometers to the semiconductor capital equipment industry, was merged with a wholly owned subsidiary of the Company. The Company issued 2.1 million shares of its common stock to the former shareholders of Sekidenko.

NOAH HOLDINGS, INC. -- On April 6, 2000, Noah Holdings, Inc. ("Noah"), a privately held, California-based manufacturer of solid state temperature control systems used to control process temperatures during semiconductor manufacturing, was merged with a wholly owned subsidiary of the Company. The Company issued approximately 687,000 shares of its common stock in connection with the acquisition. In addition, outstanding Noah stock options were converted into options to purchase approximately 40,000 shares of the Company's common stock. In April 2001 Noah was merged with its wholly owned subsidiary and the name of Noah Holdings, Inc. was changed to Noah Precision, Inc.

The Sekidenko and Noah mergers constituted tax-free reorganizations and have been accounted for as poolings of interests under Accounting Principles Board Opinion No. 16. Accordingly, all prior period consolidated financial statements presented have been restated to include the combined balance sheet, statements of operations and cash flows of Noah and Sekidenko as though each had always been part of the Company. There were no transactions between the Company, Noah and Sekidenko prior to the combinations, and immaterial adjustments were recorded at Noah and Sekidenko to conform their accounting policies. Certain reclassifications were made to conform the Noah and Sekidenko financial statements to the Company's presentations. The results of operations for the separate companies and combined amounts presented in the consolidated financial statements follow:

		NINE MONTHS ENDED SEPTEMBER 30, 2000 (UNAUDITED) (IN THOUSANDS)
Sales:		
Pre-Noah and Sekidenko mergers		
Advanced Energy .....	\$	67,171
Noah .....		3,080
Sekidenko .....		4,777
Advanced Energy and Noah combined before Sekidenko merger .....		123,190
Sekidenko before Sekidenko merger .....		7,034
Post-Sekidenko merger .....		51,794
		-----
Consolidated .....	\$	257,046
		=====
Net income:		
Pre-Noah and Sekidenko mergers		
Advanced Energy .....	\$	9,996
Noah .....		43
Sekidenko .....		1,198
Advanced Energy and Noah combined before Sekidenko merger .....		20,809
Sekidenko before Sekidenko merger .....		1,367
Noah merger costs .....		(2,333)
Post-Sekidenko merger .....		11,815
Sekidenko merger costs .....		(2,250)
		-----
Consolidated .....	\$	40,645
		=====

LITMAS -- During 1998 the Company acquired a 29% ownership interest in LITMAS, a privately held, North Carolina-based start-up company that designs and manufactures plasma gas abatement systems and high-density plasma sources. The purchase price consisted of \$1 million in cash. On October 1, 1999, the Company acquired an additional 27.5% interest in LITMAS for an additional \$560,000. The purchase price consisted of \$385,000 in the Company's common stock and \$175,000 in cash. The acquisition was accounted for using the purchase method of accounting and resulted in \$523,000 allocated to intangible assets as goodwill. The results of operations of LITMAS have been consolidated in the accompanying condensed consolidated financial statements from the date the controlling interest of 56.5% was acquired. On October 1, 2000, the Company acquired an additional 3.0% interest in LITMAS for an additional \$250,000, bringing the Company's ownership interest in LITMAS to 59.5%.

### (3) MARKETABLE SECURITIES - TRADING

MARKETABLE SECURITIES - TRADING consisted of the following:

	SEPTEMBER 30, 2001 (UNAUDITED)	DECEMBER 31, 2000 (UNAUDITED)
	-----	-----
	(IN THOUSANDS)	
Commercial paper .....	\$121,231	\$ 85,827
Municipal bonds and notes ..	6,413	54,022
Mutual funds .....	924	17,962
Treasury bills and other ...	41	--
	-----	-----
Total marketable securities	\$128,609	\$157,811
	=====	=====

These marketable securities are stated at period end market value, and have original costs of \$128,580,000 and \$157,112,000 as of September 30, 2001 and December 31, 2000, respectively. Included in the above balances is accrued interest income of \$29,000 and \$699,000 as of September 30, 2001 and December 31, 2000, respectively.

### (4) ACCOUNTS RECEIVABLE - TRADE

ACCOUNTS RECEIVABLE - TRADE consisted of the following:

	SEPTEMBER 30, 2001 (UNAUDITED)	DECEMBER 31, 2000 (UNAUDITED)
	-----	-----
	(IN THOUSANDS)	
Domestic .....	\$ 14,436	\$ 41,545
Foreign .....	24,541	31,971
Allowance for doubtful accounts	(1,034)	(784)
	-----	-----
Trade accounts receivable .....	37,943	72,732
Related parties .....	84	38
Other .....	3,546	3,775
	-----	-----
Total accounts receivable .....	\$ 41,573	\$ 76,545
	=====	=====

### (5) INVENTORIES

INVENTORIES consisted of the following:

	SEPTEMBER 30, 2001 (UNAUDITED)	DECEMBER 31, 2000 (UNAUDITED)
	-----	-----
	(IN THOUSANDS)	
Parts and raw materials	\$31,524	\$34,462
Work in process .....	2,674	3,777
Finished goods .....	12,610	7,027
	-----	-----
Total inventories .....	\$46,808	\$45,266
	=====	=====

### (6) INVESTMENTS - AVAILABLE FOR SALE AND OTHER

In the third quarter of 2000 the Company exercised warrants of a supplier in a cashless transaction and received 458,000 shares of the supplier's common stock, which is publicly traded. Concurrent with the exercise, the Company sold 320,000 shares of the supplier's common stock and recognized a gain of approximately \$4.8 million. The remaining 138,000 shares have been classified as available-for-sale securities and are reflected as an investment of approximately \$1.4 million in the accompanying balance sheet. Also included in investments is \$700,000 of private company equity securities accounted for under the cost method.

In April 2000 the Company agreed to pay a total of \$1.5 million to a privately held, early-stage developer of equipment productivity management software ("Private Company") for certain rights to use technology in connection with products sold or to be developed by the Company. As part of the \$1.5 million payments, the Company also received warrants to purchase 900,000 shares (as adjusted for subsequent splits) of Private Company common stock for \$0.056 per share. The payments have been allocated \$1,450,000 to the licensed technology rights and \$50,000 to the warrants. Subsequently, the Company was also issued 75,000 shares of Private Company common stock as consideration for guaranteeing an office lease through April 2005.

In July 2000 the Company and other investors purchased unsecured bridge notes and common stock of Private Company. The Company invested \$2.5 million and received notes valued at \$2,472,000 and 166,667 shares of Private Company common stock valued at \$28,000. The notes are convertible into shares of preferred stock of Private Company, if and when Private Company completes a subsequent placement of preferred stock. The common shares and warrants of Private Company currently held by the Company, if exercised, would represent not more than 8% ownership, assuming no other dilutive securities of Private Company were exercised.

During the third quarter of 2001 the Company advanced an additional \$2.7 million to Private Company in the form of non-convertible loans collateralized by all of Private Company's intellectual and proprietary property. The 2001 advances by the Company funded losses incurred by Private Company during the quarter ended September 30, 2001, and therefore, the Company has reflected those losses as Other Operating Expenses in the amount of \$1.2 million. The Company will record additional losses in future quarters to the extent that Private Company incurs losses that are funded solely by the Company. The Company advanced an additional \$850,000 to Private Company through November 2001. The Company has no formal commitment to make additional advances to Private Company, but future advances may be made at the Company's discretion until Private Company has developed or arranged other means of funding.

## (7) STOCKHOLDERS' EQUITY

STOCKHOLDERS' EQUITY consisted of the following:

	SEPTEMBER 30, 2001 (UNAUDITED)	DECEMBER 31, 2000 (UNAUDITED)
	-----	-----
	(IN THOUSANDS, EXCEPT PAR VALUE)	
Common stock, \$0.001 par value, 55,000 and 40,000 shares authorized, respectively; 31,795 and 31,537 shares issued and outstanding, respectively .....	\$ 32	\$ 32
Additional paid-in capital .....	129,873	124,930
Retained earnings .....	100,034	116,971
Deferred compensation .....	(1,360)	(1,620)
Unrealized holding gains on available-for-sale securities .....	1,024	1,365
Cumulative translations adjustments .....	(1,899)	(2,880)
	-----	-----
Total stockholders' equity .....	\$ 227,704	\$ 238,798
	=====	=====

## (8) ACCOUNTING POLICIES

**COMPREHENSIVE INCOME** -- Comprehensive income for the Company consists of net (loss) income, unrealized holding (loss) gain on available-for-sale securities and foreign currency translation adjustments as presented below:

	NINE MONTHS ENDED SEPTEMBER 30, 2001 (UNAUDITED) -----	NINE MONTHS ENDED SEPTEMBER 30, 2000 (UNAUDITED) -----
	(IN THOUSANDS)	
Net (loss) income, as reported .....	\$ (16,937)	\$ 40,645
Adjustment to arrive at comprehensive net (loss) income:		
Unrealized holding (loss) gain on available-for-sale marketable securities.....	(341)	4,194
Cumulative translation adjustment .....	981	(1,578)
	-----	-----
Comprehensive net (loss) income .....	\$ (16,297)	\$ 43,261
	=====	=====

**SEGMENT REPORTING** -- SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information," requires a public business enterprise to report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. Management operates and manages the Company's business as one operating segment, because all of its products and systems have similar economic characteristics and production processes. Since the Company operates in one segment, all financial segment information required by SFAS No. 131 is found in the accompanying condensed consolidated financial statements.

**DERIVATIVE INSTRUMENTS** -- In June 1998 the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Company, as required, adopted SFAS No. 133, as amended by SFAS No. 137, on January 1, 2001. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities by requiring all derivatives to be recorded on the balance sheet as either an asset or liability and measured at their fair value. Changes in the derivative's fair value will be recognized currently in earnings unless specific, hedging accounting criteria are met. SFAS No. 133 also establishes uniform hedge accounting criteria for all derivatives. The Company will not seek specific hedge accounting treatment for its foreign currency forward contracts. The adoption of SFAS No. 133 did not have a material impact on the Company's financial condition or results of operations.

The Company's subsidiary Advanced Energy Japan K.K. enters into foreign currency forward contracts to buy U.S. dollars to mitigate currency exposure from its payable position arising from trade purchases and intercompany transactions with its parent. Foreign currency forward contracts reduce the Company's exposure to the risk that the eventual net cash outflows resulting from the purchase of products denominated in other currencies will be adversely affected by changes in exchange rates. Foreign currency forward contracts are entered into with a major commercial Japanese bank that has a high credit rating, and the Company does not expect the counterparty to fail to meet its obligations under outstanding contracts. Foreign currency gains and losses under the above arrangements are not deferred. The Company generally enters into foreign currency forward contracts with maturities ranging from one to four months, with contracts outstanding at September 30, 2001 maturing through January 2002. All forward contracts are held until maturity. At September 30, 2001, the Company held foreign forward exchange contracts with nominal amounts of \$8,000,000 and market settlement amounts of \$8,038,000 for an unrealized loss position of \$38,000 that has been included in other income and expense in the accompanying condensed consolidated statement of operations.

**REVENUE RECOGNITION** -- In December 1999 the staff of the Securities and Exchange Commission issued its Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition." SAB No. 101 provides guidance on the measurement and timing of revenue recognition in financial statements of public companies. Changes in accounting policies to apply the guidance of SAB No. 101 were required to be

adopted by recording the cumulative effect of the change in the fiscal quarter ending December 31, 2000. The adoption of SAB No. 101 did not have a material effect on the Company's financial condition or results of operations.

**BUSINESS COMBINATIONS, INTANGIBLE ASSETS AND GOODWILL** -- In June 2001 the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." These statements prohibit pooling-of-interests accounting for transactions initiated after June 30, 2001, require the use of the purchase method of accounting for all combinations after June 30, 2001, and establish new standards for accounting for goodwill and other intangibles acquired in business combinations. Goodwill will continue to be recognized as an asset, but will not be amortized as previously required by APB Opinion No. 17, "Intangible Assets." Certain other intangible assets with indefinite lives, if present, may also not be amortized. Instead, goodwill and other intangible assets will be subject to periodic (at least annual) tests for impairment, and recognition of impairment losses in the future could be required based on a new methodology for measuring impairments prescribed by these pronouncements. The revised standards include transition rules and requirements for identification, valuation and recognition of a much broader list of intangibles as part of business combinations than prior practice, most of which will continue to be amortized. The Company's prospective financial statements may be significantly affected by the results of future periodic tests for impairment. In addition, the amount and timing of non-cash charges related to intangibles acquired in business combinations will change significantly from prior practice.

During the second quarter of 2001, the Company terminated the operations of its Tower Electronics, Inc. subsidiary ("Tower") and its Fourth State Technology ("FST") product line, due to declining sales of their respective products, loss of key customers, terminations of key employees and some customers' newly developed in-house capabilities. The Company reached this decision during the second quarter of 2001 after its determination that the long-term outlook for these businesses to generate cash flow was impaired, and as part of its strategic restructuring, determined that these businesses were no longer part of the Company's main focus. The Company recorded a charge of \$3.6 million of goodwill impairment related to the termination of operations of Tower and a charge of \$1.8 million of goodwill impairment related to the termination of the FST product line. These amounts represented the carrying values of these assets prior to these writedowns. These charges are disclosed as "Goodwill Impairment" in the Operating Expenses section of the accompanying unaudited condensed consolidated statement of operations.

During the second quarter of 2001, the Company implemented a restructuring program that resulted in the reduction of approximately 135 regular employees. The reduction in force began and was completed during the second quarter of 2001. The Company recorded a restructuring charge of approximately \$614,000 related primarily to severance and fringe benefits. In addition, the number of temporary and contract workers employed by the Company was also reduced. The Company paid cash to the affected employees in this amount during the second quarter of 2001, and the remaining liability is not significant.

**RECLASSIFICATIONS** -- Certain prior period amounts have been reclassified to conform to the current period presentation.

#### **(9) CONVERTIBLE SUBORDINATED NOTES PAYABLE**

In November 1999 the Company issued \$135 million of 5.25% convertible subordinated notes. These notes mature November 15, 2006, with interest payable on May 15th and November 15th each year beginning May 15, 2000. Net proceeds to the Company were approximately \$130.5 million, after deducting \$4.5 million of offering costs, which have been capitalized and are being amortized over a period of seven years. Holders of the notes may convert the notes at any time into shares of the Company's common stock, at \$49.53 per share. The Company may redeem the notes on or after November 19, 2002 at a redemption price of 103.00% times the principal amount, and may redeem at successively lesser amounts thereafter until November 15, 2006, at which time the Company may redeem at a redemption price equal to the principal amount. At September 30, 2001, approximately \$1.6 million of interest expense related to

these notes was accrued as a current liability.

In October and November 2000, the Company repurchased an aggregate of approximately \$53.4 million principal amount of its 5.25% convertible subordinated notes in the open market, for a cost of approximately \$40.8 million. These purchases resulted in an after-tax extraordinary gain of \$7.6 million. The purchased notes have been cancelled. Approximately \$81.6 million principal amount of the notes remains outstanding. The Company may continue to purchase additional notes in the open market from time to time, if market conditions and the Company's financial position are deemed favorable for such purposes.

In August 2001 the Company issued \$125 million of 5.00% convertible subordinated notes. These notes mature September 1, 2006, with interest payable on March 1st and September 1st of each year beginning March 1, 2002. Net proceeds to the Company were \$121.25 million, after deducting \$3.75 million of offering costs, which have been capitalized and are being amortized over a period of five years. Holders of the notes may convert the notes at any time before maturity into shares of the Company's common stock, at \$29.83 per share, and the conversion rate is subject to adjustment in certain circumstances. The Company may convert the notes, in whole or in part, at any time before September 4, 2004, at certain redemption prices plus accrued and unpaid interest, if any, to the date of redemption if the closing price of the Company's common stock exceeds certain prices and meets other conditions. Upon provisional redemption, if the discretionary redemption right is exercised, the Company will make an additional payment in cash with respect to the notes called for redemption in an amount equal to \$150.56 per \$1,000 principal amount of notes, less the amount of any interest paid on the note. The Company may also make this additional payment in shares of its common stock, and any such payment will be valued at 95% of the average of certain closing prices of the Company's common stock. The Company will be obligated to make an additional payment on all notes called for provisional redemption. The Company may also redeem the notes with accrued interest through, but excluding, the redemption date, from September 4, 2004 through August 31, 2005 at 102% times the principal amount, from September 1, 2005 through August 31, 2006 at 101% times the principal amount, and thereafter at 100% of the principal amount. The notes are subordinated to the Company's present and potential future senior debt, and are effectively subordinated in right of payment to all indebtedness and other liabilities of the Company's subsidiaries. At September 30, 2001, approximately \$600,000 of interest expense related to these notes was accrued as a current liability.

#### (10) LITIGATION RECOVERY

In March 2001 the Company received a \$1.5 million settlement for recovery of legal expenses pertaining to a patent-infringement suit in which the Company was the plaintiff.

#### (11) SUBSEQUENT EVENTS

On October 15, 2001, in response to the continuing downturn in the semiconductor capital equipment industry, the Company announced a reduction in force totaling approximately 107 regular employees. The reduction in force is expected to be completed in the fourth quarter of 2001, and will result in a charge of approximately \$2.5 million related to severance, fringe benefits and facilities consolidation costs.

On November 2, 2001, the Company filed a registration statement on Form S-3, related to the registration of its 5.00% convertible subordinated notes. This registration will enable the holders of the notes to trade the notes in the open market.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **SPECIAL NOTE ON FORWARD LOOKING STATEMENTS**

This Form 10-Q, including the following discussion, contains forward looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are other than historical information are forward looking statements. For example, statements relating to our beliefs, expectations and plans are forward looking statements, as are statements that certain actions, conditions or circumstances will occur or continue. Forward looking statements involve risks and uncertainties. As a result, actual results may differ materially from the results discussed in the forward looking statements. Factors that could cause or contribute to such differences or prove any forward looking statements, by hindsight, to be overly optimistic or unachievable, include, but are not limited to the following:

- changes or slowdowns in economic conditions in the semiconductor and semiconductor capital equipment industries or other industries in which our customers operate;
- changes in customers' inventory management practices;
- timing and challenges of integrating recent and potential future acquisitions;
- component shortages or allocations or other factors that change our levels of inventory or substantially increase our spending on inventory;
- introduction of new products by our competitors; and
- our ability to attract and retain key personnel.

For a discussion of these and other factors that may impact our realization of our forward looking statements, see our Annual Report on Form 10-K for the year ended December 31, 2000, Part I "Cautionary Statements - Risk Factors."

### **RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000**

#### **SALES**

We sell power conversion and control systems and related equipment primarily to the semiconductor capital equipment, data storage, flat panel display and advanced product applications markets in the United States, to the flat panel display and advanced product applications markets in the Asia Pacific region, and to data storage, semiconductor capital

equipment and advanced product applications markets in Europe. We also sell spare parts and repair services worldwide through our customer service and technical support organization.

Sales were \$96.3 million in the third quarter of 2000 and \$38.7 million in the third quarter of 2001, representing a decrease of 60%. Sales in the third quarter of 2001 decreased 16% from sales of \$46.2 million in the second quarter of 2001. The third quarter of 2001 included sales by EMCO, a wholly owned subsidiary we acquired on January 2, 2001, which was accounted for by the purchase method of accounting.

The fourth quarter of 2000 was the eighth consecutive quarter of sales growth, which was primarily attributable to capacity expansion and increased investment in advanced technology by the semiconductor industry, which began transitioning to smaller device sizes, new materials such as copper, and 300mm wafer processing. This resulted in increased demand for our systems from manufacturers of semiconductor capital equipment.

During the first quarter of 2001 and continuing through the third quarter of 2001, a worldwide slowdown in demand for semiconductors resulted in a sudden and rapid decline in demand for semiconductor manufacturing equipment. Inventory buildups, slower than expected personal computer sales and slower global economic growth resulted in reduced capital investment by semiconductor manufacturers and their suppliers. Our experience has shown that our sales to semiconductor capital equipment customers is highly correlated to the volatile and cyclical activity in this industry, which results from changes in the macroeconomic environment, changes in semiconductor supply and demand, and rapid technological advances in both semiconductor devices and wafer fabrication processes.

Our sales to the semiconductor capital equipment industry in the third quarter of 2001 decreased 73% from sales to that industry from the third quarter of 2000, and decreased 35% from sales to that industry from the second quarter of 2001. We expect sales to the semiconductor capital equipment industry for the fourth quarter of 2001 to be significantly lower than the comparable quarter in 2000.

Our sales to the data storage industry decreased 49% from the third quarter of 2000 to the third quarter of 2001, but increased 79% from the second quarter of 2001 to the third quarter of 2001. The increase was due primarily to sales to the digital video disk and compact disk markets. Sales to the flat panel display industry decreased 52% from the third quarter of 2000 to the third quarter of 2001, and were flat from the second quarter of 2001 to the third quarter of 2001. Sales to advanced product applications industries decreased 6% from the third quarter of 2000 to the third quarter of 2001.

The following tables summarize net sales and percentages of net sales by customer type for the three-month periods ended September 30, 2001 and 2000:

	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
	(IN THOUSANDS)	
Semiconductor capital equipment ..	\$18,073	\$67,142
Data storage .....	4,093	8,034
Flat panel display .....	3,722	7,733
Advanced product applications ....	9,064	9,641
Customer service technical support	3,770	3,767
	-----	-----
	\$38,722	\$96,317
	=====	=====

	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
Semiconductor capital equipment ..	47%	70%
Data storage .....	10	8
Flat panel display .....	10	8
Advanced product applications ....	23	10
Customer service technical support	10	4
	---	---
	100%	100%
	===	===

The following tables summarize net sales and percentages of net sales by geographic region for the three-month periods ended September 30, 2001 and 2000:

	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
	(IN THOUSANDS)	
United States and Canada	\$21,524	\$69,251
Europe .....	8,703	14,480
Asia Pacific .....	8,390	12,561
Rest of world .....	105	25
	-----	-----
	\$38,722	\$96,317
	=====	=====

	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
United States and Canada	56%	72%
Europe .....	22	15
Asia Pacific .....	22	13
Rest of world .....	--	--
	---	---
	100%	100%
	===	===

## GROSS MARGIN

Our gross margin was 48.6% in the third quarter of 2000 and 28.5% in the third quarter of 2001. The decrease was due to lower absorption of manufacturing overhead and fixed costs. The new facilities we added in Fort Collins, Colorado in the first quarter of 2001 to increase our manufacturing capacity increased our fixed lease and depreciation costs. This, in addition to the decline in units manufactured, adversely impacted absorption of overhead. Any further decreases in our level of sales in the future could have an additional negative impact on our gross margin.

## RESEARCH AND DEVELOPMENT EXPENSES

We invest in research and development to identify new technologies, develop new products and improve existing product designs. Our research and development expenses were \$9.7 million in the third quarter of 2000 and \$11.0 million in the third quarter of 2001, representing an increase of 13%. The increase is primarily due to increases in payroll and materials and supplies for new product development, and partly due to the

inclusion of EMCO research and development expenses in the third quarter of 2001. As a percentage of sales, research and development expenses increased from 10.0% in the third quarter of 2000 to 28.3% in the third quarter of 2001 because of the higher spending and lower sales levels.

We believe continued investment in the research and development of new systems is critical to our long-term strategy and our ongoing commitment to product development to serve new and existing markets, and we continue to invest in new product development during industry downturns. Since our inception, the majority of our research and development costs generally have been internally funded and all have been expensed as incurred.

### **SALES AND MARKETING EXPENSES**

Our sales and marketing expenses support domestic and international sales and marketing activities which include personnel, trade shows, advertising, and other marketing activities. Sales and marketing expenses were \$6.2 million in the third quarter of 2000 and \$5.7 million in the third quarter of 2001, representing a 9% decrease. The decrease is primarily due to lower payroll, travel and distribution costs partially offset by the inclusion of EMCO selling and marketing expenses in the third quarter of 2001. As a percentage of sales, sales and marketing expenses increased from 6.5% in the third quarter of 2000 to 14.7% in the third quarter of 2001 because of the lower sales levels.

### **GENERAL AND ADMINISTRATIVE EXPENSES**

Our general and administrative expenses support our worldwide financial, administrative, information systems and human resources functions. General and administrative expenses were \$6.7 million in the third quarter of 2000 and \$4.8 million in the third quarter of 2001, representing a 29% decrease. The decrease is primarily due to lower payroll and purchased services, partially offset by higher goodwill amortization resulting from the acquisition of EMCO. Goodwill amortization related to our other businesses was lower due to a charge of \$5.4 million of goodwill impairment separately reported in the second quarter of 2001. As a percentage of sales, general and administrative expenses increased from 7.0% in the third quarter of 2000 to 12.4% in the third quarter of 2001 because of the lower sales levels.

We continue to implement our management system software, including the replacement of existing systems in our domestic and foreign locations. We expect that charges related to personnel training and implementation of our management system software will continue through 2002.

### **OTHER OPERATING EXPENSES**

In September 2001 we recognized a \$1.2 million charge related to the funding of losses incurred by a private company technology investment, which is detailed in Note 6.

## OTHER (EXPENSE) INCOME

Other expense (income) consists primarily of interest income and expense, foreign exchange gains and losses and other miscellaneous gain, loss, income and expense items. Other income was \$5.6 million in the third quarter of 2000, primarily due to a \$4.8 million gain on a sale of an investment. Other expense was \$711,000 in the third quarter of 2001, and included \$1.3 million of interest income offset by \$1.9 million of interest expense, \$107,000 of foreign currency gain and \$226,000 of other expenses.

## (BENEFIT) PROVISION FOR INCOME TAXES

The income tax provision for the third quarter of 2000 was \$10.2 million and represented an effective tax rate of 38%. The income tax benefit for the third quarter of 2001 was \$4.7 million. Changes in our earnings relative to the earnings of our foreign subsidiaries affected our consolidated effective tax rate. We adjust our provision for income taxes periodically based upon the anticipated tax status of our foreign and domestic entities.

## RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000

### SALES

Sales were \$257.0 million for the first nine months of 2000 and \$159.6 million for the first nine months of 2001. The decrease was attributable to decreased sales to semiconductor capital equipment, data storage and flat panel display customers. Sales to the United States, Canada, Europe and Asia Pacific were lower in the first nine months of 2001 when compared to the first nine months of 2000. Sales in the first nine months of 2001 included sales by EMCO, a wholly owned subsidiary we acquired in January 2001.

The following tables summarize net sales and percentages of net sales by customer type for the nine-month periods ended September 30, 2001 and 2000:

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
	(IN THOUSANDS)	
Semiconductor capital equipment ..	\$ 96,876	\$179,227
Data storage .....	8,576	19,404
Flat panel display .....	14,167	21,363
Advanced product applications ....	28,357	25,784
Customer service technical support	11,631	11,268
	-----	-----
	\$159,607	\$257,046
	=====	=====

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
Semiconductor capital equipment ..	61%	70%
Data storage .....	5	8
Flat panel display .....	9	8
Advanced product applications ....	18	10
Customer service technical support	7	4
	---	---
	100%	100%
	===	===

The following tables summarize net sales and percentages of net sales by geographic region for the nine-month periods ended September 30, 2001 and 2000:

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
	(IN THOUSANDS)	
United States and Canada	\$102,885	\$185,470
Europe .....	24,323	38,117
Asia Pacific .....	31,833	33,147
Rest of world .....	566	312
	-----	-----
	\$159,607	\$257,046
	=====	=====

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	----	----
United States and Canada	64%	72%
Europe .....	15	15
Asia Pacific .....	21	13
Rest of world .....	--	--
	---	---
	100%	100%
	===	===

### GROSS MARGIN

Our gross margin was 49.0% in the first nine months of 2000 and 31.4% in the first nine months of 2001. The decrease was due to lower absorption of manufacturing overhead and fixed costs and a \$7.1 million writedown related to the identification and future disposal of excess and obsolete inventory and additional warranty provision recorded to reflect our current experience and anticipated incremental repairs and retrofits. The new facilities we added in Fort Collins, Colorado in the first quarter of 2001 to increase our manufacturing capacity increased our fixed lease and depreciation costs. This, in addition to the decline in units manufactured, adversely impacted absorption of overhead. Also, the sudden and pronounced decline in demand caused a significant increase in inventories deemed to be excessive or obsolete. Any further decreases in our level of sales in the future could have an additional negative impact on our gross margin.

### RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were \$26.3 million in the first nine months of 2000 and \$34.4 million in the first nine months of 2001, representing an increase of 31%. The increase is primarily due to increases in payroll, materials and supplies, purchased services and higher infrastructure costs for new product development, and partly due to the inclusion of EMCO research and development expenses in the first nine months of 2001. As a percentage of sales, research and development expenses increased from 10.2% in the first nine months of 2000 to 21.6 % in the first nine months of 2001 because of the higher spending and lower sales levels.

### SALES AND MARKETING EXPENSES

Sales and marketing expenses were \$17.5 million in the first nine months of 2000 and \$18.3 million in the first nine months of 2001, representing a 5% increase. The increase is

primarily due to the inclusion of EMCO sales and marketing expenses in the first nine months of 2001. We incurred these expenses to continue to increase our sales management and product management capabilities. As a percentage of sales, sales and marketing expenses increased from 6.8% in the first nine months of 2000 to 11.5% in the first nine months of 2001 because of the higher spending and lower sales levels.

### **GENERAL AND ADMINISTRATIVE EXPENSES**

General and administrative expenses were \$18.2 million in the first nine months of 2000 and \$16.6 million in the first nine months of 2001, representing a 9% decrease. The decrease is primarily due to lower spending for payroll and purchased services, partially offset by higher goodwill amortization resulting from the acquisition of EMCO. Goodwill amortization related to our other businesses was lower due to a charge of \$5.4 million of goodwill impairment separately reported in the second quarter of 2001. As a percentage of sales, general and administrative expenses increased from 7.1% in the first nine months of 2000 to 10.4% in the first nine months of 2001.

### **RESTRUCTURING AND MERGER COSTS AND OTHER OPERATING EXPENSES**

In April 2000 the Company acquired Noah Holdings, Inc. ("Noah") in a pooling of interests under the previous rules of Accounting Principles Board (APB) Opinion No. 16. The merger involved the exchange of 687,000 shares of Advanced Energy common stock for the privately held common stock of Noah. As part of the business combination, we took a charge of \$2.3 million in the second quarter of 2000 for merger costs, which cannot be capitalized and which in certain cases were nondeductible for income tax purposes. In July 2001 the Financial Accounting Standards Board issued SFAS No. 141, which requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001.

In July 2000 we announced the consolidation of our Tower Electronics facility in Fridley Minnesota, into our existing facility in Voorhees, New Jersey. We recorded a restructuring charge of \$1.0 million in the third quarter of 2000 related to the consolidation, which was completed during the fourth quarter of 2000.

In August 2000 the Company acquired Sekidenko, Inc. ("Sekidenko") in a merger that was accounted for as a pooling of interests. This merger involved the exchange of 2.1 million shares of Advanced Energy common stock for the privately held common stock of Sekidenko. As part of the business combination, we took a charge of \$2.3 million in the third quarter of 2000 for merger costs, which cannot be capitalized and which in certain cases were nondeductible for income tax purposes.

During the second quarter of 2001, in response to the downturn in the semiconductor capital equipment industry, we implemented two reductions in force totaling approximately 135 regular employees and recorded a charge of \$614,000 for restructuring

and severance costs, including fringe benefits. In addition, we also reduced the number of temporary and contract workers. We paid cash to the affected employees in this amount during the second quarter of 2001, and at September 30, 2001 the remaining liability was not significant.

In September 2001 we recognized a \$1.2 million charge related to the funding of losses incurred by a private company technology investment, which is detailed in Note 6.

### **OTHER INCOME (EXPENSE)**

Other income (expense) consists primarily of interest income and expense, foreign exchange gains and losses and other miscellaneous gain, loss, income and expense items. Other income was \$6.4 million in the first nine months of 2000, primarily due to a \$4.8 million gain on a sale of an investment and net interest income from marketable securities we hold. Other expense was \$594,000 in the first nine months of 2001, due primarily to other non-operating corporate expenses. Net interest income and expense for the first nine months of 2001 netted to approximately \$2,000 of income.

### **(BENEFIT) PROVISION FOR INCOME TAXES**

The income tax provision for the first nine months of 2000 was \$24.2 million and represented an effective tax rate of 37%. The income tax benefit for the first nine months of 2001 was \$8.6 million. Changes in our earnings relative to the earnings of our foreign subsidiaries and the writedown of certain intangible assets affected our consolidated effective tax rate. We adjust our provision for income taxes periodically based upon the anticipated tax status of our foreign and domestic entities.

### **LIQUIDITY AND CAPITAL RESOURCES**

Since our inception, we have financed our operations, acquired equipment and met our working capital requirements through borrowings under our revolving lines of credit, long-term loans secured by property and equipment, cash flow from operations and proceeds from underwritten public offerings of our common stock and convertible subordinated debt.

Operating activities provided cash of \$12.3 million in the first nine months of 2000, primarily as a result of net income, exclusive of non-cash charges, reduced by a net increase in non-cash working capital, primarily accounts receivable and inventories of approximately \$40.4 million. Operating activities provided cash of \$2.3 million in the first nine months of 2001, primarily as a result of non-cash charges and a decrease in non-cash working capital, principally accounts receivable and inventories, of approximately \$31.5 million.

Investing activities used cash of \$12.6 million in the first nine months of 2000, and

included the purchase of marketable securities of \$5.0 million, property and equipment for \$8.7 million, investments of \$1.0 million and advances under notes receivable of \$2.5 million, partially offset by proceeds from the sale of an investment of \$4.5 million and proceeds from the sale of equipment of \$150,000. Investing activities used cash of \$9.5 million in the first nine months of 2001, and included the acquisition of EMCO for \$29.9 million, the purchase of property and equipment for \$10.8 million, investments for \$639,000 and net advances under notes receivable of \$1.5 million, partially offset by the sale of marketable securities of \$33.3 million.

Financing activities provided cash of \$4.0 million in the first nine months of 2000, and consisted primarily of \$4.0 million from the exercise of employee stock options and sale of common stock through our employee stock purchase plan ("ESPP"). Financing activities provided cash of \$122.2 million in the first nine months of 2001, and included proceeds of \$121.25 million from convertible subordinated debt and \$3.0 million from the exercise of employee stock options and sale of common stock through our ESPP, offset by \$2.1 million of net decreases in notes payable and capital lease obligations.

We plan to limit capital spending to items crucial to our operations through the remainder of 2001. Depreciation expense is projected to be approximately \$2.7 million for the fourth quarter of 2001.

As of September 30, 2001, we had working capital of \$362.3 million. Our principal sources of liquidity consisted of \$147.7 million of cash and cash equivalents, \$128.6 million of marketable securities, and a credit facility consisting of a \$30.0 million revolving line of credit. Advances under the revolving line of credit bear interest at either the prime rate (5.50% at October 31, 2001) minus 1.00% or the LIBOR 360-day rate 2.7188% at October 31, 2001) plus 175 basis points, at our option. All advances under the revolving line of credit will be due and payable May 2003. As of September 30, 2001 there were no advances outstanding on this line of credit.

We believe that our cash and cash equivalents, marketable securities, cash flow from operations and available borrowings, will be sufficient to meet our working capital needs through at least the end of 2002. After that time, we may require additional equity or debt financing to address our working capital, capital equipment or expansion needs. In addition, any significant acquisitions we make may require additional equity or debt financing to fund the purchase price, if paid in cash. There can be no assurance that additional funding will be available when required or that it will be available on terms acceptable to us.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **INTEREST RATE RISK**

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and long-term debt obligations. We generally place our investments with high credit quality issuers and by policy are averse to principal loss and seek to protect and preserve our invested funds by limiting default risk, market risk and reinvestment risk.

As of September 30, 2001, our investments consisted primarily of equity securities, commercial paper, municipal bonds and notes and money market mutual funds which had an original cost of \$248.2 million, and earned approximately \$1.2 million for the quarter then ended, at an average interest rate of approximately 2.9%. The impact on interest income of a decrease of ten percent in the average interest rate would have resulted in approximately \$120,000 less interest income for the quarter ended September 30, 2001.

As of September 30, 2001, all of our debt was at fixed interest rates. The impact on interest expense of a ten percent increase in the average interest rate would have been immaterial to our financial position and results of operations.

#### **FOREIGN CURRENCY EXCHANGE RATE RISK**

We transact business in various foreign countries. Our primary foreign currency cash flows are generated in countries in Asia and Europe. We have entered into various forward foreign exchange contracts to mitigate against currency fluctuations in the Japanese yen. These currency swaps offset changes in the exchange rate in the yen, when intercompany transactions we conduct with our subsidiary in Japan are settled. Changes in the exchange rates of the U.S. dollar with other currencies in which we operate are immaterial. We will continue to evaluate various methods to minimize the effects of currency fluctuations.

Eleven European countries adopted a Single European Currency (the "euro") as of January 1, 1999 with a transition period continuing through at least January 1, 2002. As of January 1, 1999, these eleven of the fifteen member countries of the European Union (the "participating countries") established fixed conversion rates between their existing sovereign currencies and the euro. For three years after the introduction of the euro, the participating countries can perform financial transactions in either the euro or their original local currencies. This will result in a fixed exchange rate among the participating countries, whereas the euro (and the participating countries' currencies in tandem) will continue to float freely against the U.S. dollar and other currencies of non-participating countries. A twelfth European country adopted the euro on January 1, 2001. Although we do not expect the introduction of the euro currency to have a significant impact on our revenues or results of operations, we are unable to determine what effects, if any, the

currency change in Europe will have on competition and competitive pricing in the affected regions.

## **OTHER RISK**

We have invested in start-up companies and may in the future make additional investments in start-up companies that develop products which we believe may provide future benefits. The current start-up investments and any future start-up investments will be subject to all of the risks inherent in investing in companies that are not established, and may result in charges being recorded in our periodic statements of operations.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

From time to time, we are party to various legal proceedings relating to our business. We are not currently party to any material legal proceedings, except the civil action described in our quarterly report on Form 10-Q for the quarter ended March 31, 2001, filed May 9, 2001.

### **ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS**

Not applicable.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

### **ITEM 5. OTHER INFORMATION**

None.

### **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits:

3.1 The Company's Restated Certificate of Incorporation, as amended(1)

3.2 The Company's By-laws(2)

4.1 Indenture dated August 27, 2001 between State Street Bank and Trust Company of California, N.A., as trustee, and the Company (including form of 5.00% Convertible Subordinated Note due September 1, 2006)(3)

4.2 Registration Rights Agreement, dated as of August 22, 2001, between the Company and Goldman, Sachs and Co.(3)

(1) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 000-26966), filed August 13, 2001.

(2) Incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 33-97188), filed September 20, 1995, as amended.

(3) Incorporated by reference to the Company's Current Report on Form 8-K (File No. 000-26966), filed September 10, 2001.

(b) The Company filed a report on Form 8-K on July 11, 2001. The report contained the Company's press release, dated July 11, 2001, announcing the Company's financial results for the second fiscal quarter of 2001 and six-month period ended June 30, 2001.

The Company filed a report on Form 8-K on September 10, 2001. The report described the Company's sale and issuance of \$125 million of convertible subordinated notes payable due 2006 to qualified institutional buyers in a private placement. The closing of the offering took place on August 27, 2001, and resulted in net proceeds of approximately \$121.25 million to the Company. The report also included a summary of the material provisions of the notes, the indenture and the registration rights agreement.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ADVANCED ENERGY INDUSTRIES, INC.**

*/s/ Michael El-Hillow*  
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*Michael El-Hillow*

Senior Vice President, Chief Financial November 13, 2001 Officer (Principal Financial Officer and Principal Accounting Officer)

## INDEX TO EXHIBITS

3.1 The Company's Restated Certificate of Incorporation, as amended(1)

3.2 The Company's By-laws(2)

4.1 Indenture dated August 27, 2001 between State Street Bank and Trust Company of California, N.A., as trustee, and the Company (including form of 5.00% Convertible Subordinated Note due September 1, 2006)(3)

4.2 Registration Rights Agreement, dated as of August 22, 2001, between the Company and Goldman, Sachs and Co.(3)

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(1) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 000-26966), filed August 13, 2001.

(2) Incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 33-97188), filed September 20, 1995, as amended.

(3) Incorporated by reference to the Company's Current Report on Form 8-K (File No. 000-26966), filed September 10, 2001.

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**End of Filing**

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