

ADVANCED ENERGY INDUSTRIES INC

FORM 10-Q (Quarterly Report)

Filed 11/12/1998 For Period Ending 9/30/1998

Address	1625 SHARP POINT DR FT COLLINS, Colorado 80525
Telephone	970-221-4670
CIK	0000927003
Industry	Electronic Instr. & Controls
Sector	Technology
Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 1998.

**[] 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: 0-26966

ADVANCED ENERGY INDUSTRIES, INC.

(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 X No ___.

As of November 10, 1998, there were 26,681,691 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. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (IN THOUSANDS)

	SEPTEMBER 30, 1998 (UNAUDITED)	DECEMBER 31, 1997
ASSETS	-----	-----
CURRENT ASSETS:		
Cash and cash equivalents.....	\$ 9,985	\$ 11,470
Marketable securities - trading.....	19,218	20,174
Accounts receivable, net.....	16,575	28,386
Income tax receivable.....	1,138	--
Inventories.....	19,023	26,243
Other current assets.....	1,093	2,472
Deferred income tax assets, net.....	3,031	2,836
	-----	-----
Total current assets.....	70,063	91,581
	-----	-----
PROPERTY AND EQUIPMENT, net.....	12,782	11,331
OTHER ASSETS:		
Deposits and other.....	1,218	500
Goodwill and other intangibles, net.....	8,814	7,112
Demonstration and customer service equipment, net.....	1,914	1,719
	-----	-----
Total assets.....	\$ 94,791	\$112,243
	-----	-----
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable trade.....	\$ 4,760	\$ 12,045
Accrued payroll and employee benefits.....	3,577	5,243
Other accrued expenses.....	1,401	1,327
Customer deposits.....	40	226
Accrued income taxes payable.....	--	2,734
Current portion of long-term debt.....	35	3,298
	-----	-----
Total current liabilities.....	9,813	24,873
	-----	-----
LONG-TERM LIABILITIES:		
Long-term debt.....	--	22
	-----	-----
Total liabilities.....	9,813	24,895
	-----	-----
STOCKHOLDERS' EQUITY.....	84,978	87,348
	-----	-----
Total liabilities and stockholders' equity.....	\$ 94,791	\$112,243
	-----	-----

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

ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	THREE MONTHS ENDED SEPTEMBER 30,	
	1998 (UNAUDITED)	1997 (UNAUDITED)
SALES.....	\$21,927	\$42,571
COST OF SALES.....	14,994	25,538
	-----	-----
Gross profit.....	6,933	17,033
	-----	-----
OPERATING EXPENSES:		
Research and development.....	4,440	4,072
Sales and marketing.....	2,775	2,329
General and administrative.....	1,770	1,943
Restructuring charge.....	1,000	--
Storm damage.....	--	3,000
Purchased in-process research and development.....	--	3,080
	-----	-----
Total operating expenses.....	9,985	14,424
	-----	-----
(LOSS) INCOME FROM OPERATIONS.....	(3,052)	2,609
OTHER (EXPENSE) INCOME.....	(157)	54
	-----	-----
Net (loss) income before income taxes.....	(3,209)	2,663
PROVISION FOR INCOME TAXES.....	(1,070)	2,146
	-----	-----
NET (LOSS) INCOME.....	\$ (2,139)	\$ 517
	-----	-----
BASIC (LOSS) EARNINGS PER SHARE.....	\$ (0.09)	\$ 0.02
	-----	-----
DILUTED EARNINGS PER SHARE.....	NA	\$ 0.02
	-----	-----
BASIC WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING.....	22,588	21,378
	-----	-----
DILUTED WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING.....	NA	22,372
	-----	-----

	NINE MONTHS ENDED SEPTEMBER 30,	
	1998 (UNAUDITED)	1997 (UNAUDITED)
SALES.....	\$84,755	\$95,928
COST OF SALES.....	59,652	58,835
	-----	-----
Gross profit.....	25,103	37,093
	-----	-----
OPERATING EXPENSES:		
Research and development.....	13,856	10,406
Sales and marketing.....	8,686	6,464
General and administrative.....	5,837	4,893
Restructuring charge.....	1,000	--
Storm damage.....	--	3,000
Purchased in-process research and development.....	--	3,080
	-----	-----
Total operating expenses.....	29,379	27,843
	-----	-----
(LOSS) INCOME FROM OPERATIONS.....	(4,276)	9,250
OTHER INCOME (EXPENSE).....	190	(46)
	-----	-----
Net (loss) income before income taxes.....	(4,086)	9,204
PROVISION FOR INCOME TAXES.....	(1,403)	4,632
	-----	-----
NET (LOSS) INCOME.....	\$ (2,683)	\$ 4,572
	-----	-----

	-----	-----
BASIC (LOSS) EARNINGS PER SHARE.....	\$ (0.12)	\$ 0.21
	-----	-----
DILUTED EARNINGS PER SHARE.....	NA	\$ 0.21
		=====
BASIC WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING.....	22,543	21,311
	-----	-----
DILUTED WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING.....	NA	21,994

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

ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	NINE MONTHS ENDED SEPTEMBER 30,	
	1998 (UNAUDITED)	1997 (UNAUDITED)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income.....	\$ (2,683)	\$ 4,572
Adjustments to reconcile net (loss) income to net cash provided by operating activities --		
Depreciation and amortization.....	4,036	2,521
Purchased in-process research and development.....	--	3,080
Provision for deferred income taxes.....	(195)	--
Amortization of deferred compensation.....	34	36
Loss on disposal of property and equipment.....	39	3
Earnings from marketable securities, net.....	(544)	--
Writedown of stock investment.....	300	--
Changes in operating assets and liabilities --		
Accounts receivable-trade, net.....	10,403	(15,648)
Related parties and other receivables.....	1,408	(1,171)
Inventories.....	7,220	(4,244)
Other current assets.....	241	(596)
Deposits and other.....	(18)	648
Demonstration and customer service equipment.....	(820)	65
Accounts payable, trade.....	(7,285)	9,688
Accrued payroll and employee benefits.....	(1,666)	2,178
Customer deposits and other accrued expenses.....	(112)	(79)
Income taxes payable.....	(2,734)	(300)
Net cash provided by operating activities.....	7,624	753
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sale of marketable securities, net.....	1,500	--
Purchase of property and equipment, net.....	(4,103)	(2,730)
Purchase of preferred stock of Litmas, Inc.....	(1,000)	--
Acquisition of assets of Fourth State Technology, Inc.....	(2,500)	--
Acquisition of Tower Electronics, Inc., net of cash acquired.....	--	(12,061)
Net cash used in investing activities.....	(6,103)	(14,791)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes receivable.....	--	690
Net change from notes payable and capital lease obligations.....	(3,285)	11,275
Proceeds from sale of common stock.....	393	132
Net cash (used in) provided by financing activities.....	(2,892)	12,097
EFFECT OF CURRENCY TRANSLATION ON CASH FLOW.....	(114)	(40)
DECREASE IN CASH AND CASH EQUIVALENTS.....	(1,485)	(1,981)
CASH AND CASH EQUIVALENTS, beginning of period.....	11,470	11,231
CASH AND CASH EQUIVALENTS, end of period.....	\$ 9,985	\$ 9,250
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Exercise of stock options in exchange for stockholders' notes receivable	\$ --	\$ 148
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest.....	\$ 121	\$ 232
Cash paid for income taxes.....	\$ 2,255	\$ 3,320

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

ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) BASIS OF PRESENTATION AND MANAGEMENT OPINION

In the opinion of management, the accompanying unaudited consolidated balance sheets and statements of operations and cash flows contain all adjustments, consisting only of normal recurring items, 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, 1998, and the results of their operations and cash flows for the three- and nine-month periods ended September 30, 1998 and September 30, 1997.

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 latest Annual Report on Form 10-K for the year ended December 31, 1997.

(2) ACQUISITIONS

Effective August 15, 1997, the Company acquired all of the outstanding stock of Tower Electronics, Inc. ("Tower"), a Minnesota-based designer and manufacturer of custom, high-performance switchmode power supplies used principally in the telecommunications, medical and non-impact printing industries. The purchase price consisted of \$14.5 million in cash and a \$1.5 million non-interest-bearing promissory note to the seller (the "Note"). The Company paid the Note in August 1998. Total consideration, including the effect of imputing interest on the Note, equaled \$15,889,000. The acquisition was accounted for using the purchase method of accounting and resulted in a one-time charge of \$3,080,000 for in-process research and development acquired as a result of the transaction. Acquisition costs totaled approximately \$209,000. The results of operations of Tower are included within the accompanying consolidated financial statements for the three- and nine-month periods ended September 30, 1998 and September 30, 1997, from the date of acquisition.

Effective September 3, 1998, the Company acquired substantially all of the assets of Fourth State Technology, Inc. ("FST"), a privately held, Texas-based designer and manufacturer of process controls used to monitor and analyze data in the RF process. The purchase price consisted of \$2.5 million in cash and an earn out provision which will entitle FST to receive additional payouts based on the profitability of the business unit over a three-year period. The results of operations of FST are included within the accompanying consolidated financial statements for the three- and nine-month periods ended September 30, 1998, from the date of acquisition.

(3) UNDERWRITTEN PUBLIC OFFERING

In October 1997, the Company closed an underwritten offering of its common stock. In connection with this offering, 1,000,000 shares of common stock were sold by the Company at a price of \$31 per share, providing gross proceeds of \$31,000,000. Offering costs and underwriters' commissions totaled \$2,276,000.

(4) ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following:

	SEPTEMBER 30, 1998 (UNAUDITED)	DECEMBER 31, 1997
	-----	-----
	(IN THOUSANDS)	
Domestic.....	\$ 8,803	\$16,724
Foreign.....	7,411	9,854
Allowance for doubtful accounts.....	(467)	(428)
	-----	-----
Trade accounts receivable.....	\$15,747	\$26,150
Related parties.....	271	893
Other.....	557	1,343
	-----	-----
Total accounts receivable.....	\$16,575	\$28,386
	-----	-----

(5) INVENTORIES

Inventories consisted of the following:

	SEPTEMBER 30, 1998 (UNAUDITED)	DECEMBER 31, 1997
	-----	-----
	(IN THOUSANDS)	
Parts and raw materials.....	\$13,211	\$18,549
Work in process.....	1,937	2,542
Finished goods.....	3,875	5,152
	-----	-----
Total inventories.....	\$19,023	\$26,243
	-----	-----

(6) EARNINGS PER SHARE

In February 1997, the Financial Accounting Standards Board issued SFAS No. 128, "Earnings Per Share," which requires companies to present basic earnings per share ("EPS") and diluted EPS, instead of the primary and fully-diluted EPS that were previously required. The new standard is effective for the Company in fiscal 1997 and all prior periods have been retroactively adjusted. Basic EPS is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. Diluted earnings per share are not reported for 1998 due to the anti-dilutive effect.

(7) STOCKHOLDERS' EQUITY

Stockholders' equity consisted of the following:

	SEPTEMBER 30, 1998 (UNAUDITED)	DECEMBER 31, 1997
	-----	-----
	(IN THOUSANDS, EXCEPT PAR VALUE)	
Common stock, \$0.001 par value, 30,000 shares authorized; 22,627 and 22,493 shares issued and outstanding at September 30, 1998 and December 31, 1997, respectively.....	\$ 23	\$ 22
Additional paid-in capital.....	53,017	52,625
Retained earnings.....	32,744	35,427
Deferred compensation.....	--	(34)
Cumulative translation adjustment.....	(806)	(692)
	-----	-----
Total stockholders' equity.....	\$84,978	\$87,348
	-----	-----

(8) ACCOUNTING STANDARDS

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 130 ("SFAS 130"), "Reporting Comprehensive Income," which is required to be adopted by the Company in fiscal 1998. Reclassification of financial statements for earlier periods provided for comparative purposes is required. SFAS 130 establishes standards for the reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. The Company adopted SFAS 130 in the first quarter of fiscal 1998.

	NINE MONTHS ENDED SEPTEMBER 30, 1998 (UNAUDITED)	NINE MONTHS ENDED SEPTEMBER 30, 1997 (UNAUDITED)
	-----	-----
	(IN THOUSANDS)	
Net (loss) income, as reported.....	\$ (2,683)	\$4,572
Adjustment to arrive at comprehensive net (loss) income:		
Cumulative translation adjustment.....	(114)	(40)
	-----	-----
Comprehensive net (loss) income.....	\$ (2,797)	\$4,532
	-----	-----

In June 1998, the FASB issued SFAS No. 133, ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities" which establishes accounting and reporting standards for derivative instruments and for hedging activity. SFAS 133 is effective for all periods in fiscal years beginning after June 15, 1999. SFAS 133 requires 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 133 also establishes uniform hedge accounting criteria for all derivatives. The Company has not yet evaluated the impact that the adoption of SFAS 133 will have on the financial statements.

(9) SUBSEQUENT EVENT

On October 8, 1998, the Company acquired RF Power Products, Inc. ("RFPP") by issuing approximately 4,000,000 shares of stock. The acquisition will be accounted for as a pooling of interests. RFPP will operate as a wholly owned subsidiary of the Company. RFPP, a New Jersey-based company, designs and manufactures radio frequency (RF) power systems, including generators and matching networks, primarily for capital equipment manufacturers in the semiconductor, flat panel display and thin film disk media markets.

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

The following discussion contains, in addition to historical information, 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. For example, statements relating to the Company's beliefs, expectations and plans are forward-looking statements, as are statements that certain actions, conditions or circumstances will continue. Forward-looking statements involve risks and uncertainties. As a result, the Company's 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: the significant fluctuations in the Company's quarterly operating results, the volatility of the semiconductor and semiconductor capital equipment industries, timing and success of integration of recent and potential future acquisitions, supply constraints and technological changes. For a discussion of these and other factors that may impact the Company's realization of its forward-looking statements, see the Company's Annual Report on Form 10-K for the year ended December 31, 1997 Part I

"CAUTIONARY STATEMENTS - RISK FACTORS."

YEAR 2000 PROGRAM

The Year 2000 problem is the result of computer programs that rely on two-digit date codes, instead of four-digit date codes, to indicate the year. Such computer programs, which are unable to interpret the date code "00" as the year 2000, may not be able to perform computations and decision-making functions and could cause computer systems to malfunction. The Company has developed a multi-phase program for Year 2000 information systems compliance that consists of (i) assessment of the corporate systems and operations of the Company that could be affected by the Year 2000 problem, (ii) remediation of non-compliant systems and components, and (iii) testing of systems and components following remediation. The Company has focused its Year 2000 review on three areas: (A) information technology (IT) system applications, (B) non-IT systems, including engineering and manufacturing applications, and (C) relationships with third parties.

The Company has conducted an initial assessment of the Year 2000 problem on its IT and non-IT systems used at its facilities in Fort Collins, Colorado. Assessment at the Company's systems used at facilities outside Fort Collins (the "Other Facilities") is underway. Recent acquisitions by the Company have increased the size and number of Other Facilities. As a result, the Company's Year 2000 team has determined to conduct the Year 2000 program at the Other Facilities separately from the Fort Collins facility.

The Company expects to complete the assessment phase at the Other Facilities during the fourth quarter of 1998. The Company believes that its enterprise-wide software system, which is installed at the Fort Collins facility and certain Other Facilities, is Year 2000 compliant. Such belief is based significantly on discussions with and representations by the vendor of such software. The Company has been, and will continue to be, in contact with such vendor in order to obtain any additional revisions or upgrades issued by the vendor to ensure that such enterprise-wide software remains Year 2000 compliant.

Following completion of the assessment phase in Fort Collins, the Year 2000 team identified those non-compliant systems that it considers to be "mission critical." Remediation of the mission critical systems, as well as certain other non-compliant systems, is underway. The Year 2000 team expects to complete remediation of the mission critical IT systems in Fort Collins by the end of 1998, and to complete remediation of the mission critical non-IT systems in Fort Collins by the second quarter of 1999. Remediation of non-compliant systems at Other Facilities is being conducted as the assessment phase nears completion; however, assessment at certain Other Facilities has just begun. Until the assessment phase at the Other Facilities is complete, the Company cannot determine the extent of remediation that will be required or the time by which such remediation will be complete. The Company does not expect that significant remediation will be required at the Other Facilities.

The Company is examining its relationship with third parties whose Year 2000 compliance could have material effect on the Company. The Company considers third party suppliers and customers to pose the greatest Year 2000 risk to the Company, because the failure of such persons to become Year 2000 compliant in a timely manner, if at all, could result in the Company's inability to obtain components in a timely manner, reductions in the quality of components obtained, reductions, delays or cancellations of customer orders or delay in payments by customers for products shipped. In addition, conversions by third parties to become Year 2000 compliant might not be compatible with the Company's systems. Any or all of these events could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company has circulated questionnaires to all of its significant vendors and customers with respect to such persons' Year 2000 compliance programs and status. The Company has received current responses to its questionnaires from approximately half of such suppliers and customers. Based on such responses, the Company believes that such suppliers and customers are either Year 2000 compliant or are implementing plans to become Year 2000 compliant in a timely manner. The Company will be conducting more extensive assessments of its principal suppliers' Year 2000 readiness, which may include holding meetings specifically addressing the Year 2000 problem and site visits.

In what the Company believes to be the most likely worst case Year 2000 scenario, the Company would be unable to obtain electronic components from its suppliers because of such third parties' failure to become Year 2000 compliant, and the Company would be unable to manufacture such components internally or to redesign its systems to

accommodate different components because of the failure of the Company's engineering and manufacturing systems to be Year 2000 compliant. The Company is in the process of reviewing the capabilities of its current and other component suppliers to ensure that the components most critical to the Company's products are not sole-sourced. See "Cautionary Statements - Risk Factors--Supply Constraints and Dependence on Sole and Limited Source Suppliers" in the Company's 1997 Annual Report on Form 10-K.

Although the Company is continuing to assess Year 2000 costs, it does not expect the costs associated with such projects to have a material effect on the Company's financial results. The Company expects to spend less than five percent of its total IT budget on Year 2000 costs. The Company has not identified any IT projects that have been deferred due to its Year 2000 efforts. The Company's current estimates of the impact of the Year 2000 problem on its operations and financial results do not include costs and time that may be incurred as a result of any vendors' or customers' failures to become Year 2000 compliant on a timely basis.

The foregoing beliefs and expectations are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, and are based in large part on certain statements and representations made by persons outside the Company, any of which statements or representations ultimately could prove to be inaccurate.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

SALES

Sales for the third quarter of 1998 were \$21.9 million, a decrease of 49% from third quarter of 1997 sales of \$42.6 million. The decrease in sales between such periods has resulted from decreased unit sales of the Company's systems. The decrease in sales was attributable mostly to semiconductor capital equipment customers in the United States, particularly to the Company's largest customer in that industry. The third quarter of 1998 continued to reflect the impact of the current downturn in the semiconductor capital equipment market and continuation of the Asian financial crisis. Many of the customers to whom the Company's OEM customers sell are located in Asia and Japan.

Although sales to the data storage equipment market decreased significantly on a worldwide basis, sales to the Company's largest customer in that industry almost doubled. Sales to the flat panel display industry in Japan were less than one-eighth of the level of the comparable period last year. Sales to industrial markets were down moderately. The Company sells primarily to the semiconductor capital equipment, data storage and industrial markets in the United States, to the flat panel display and data storage markets in Japan, and to the data storage and industrial markets in Europe. The Company also sells spare parts and repair services worldwide through its customer service technical support organization. Changes in the economies of the countries in

which the Company does business can impact the geographic and industrial mixes of the sales by the Company.

Sales by industry segment for the three months ended September 30, 1998 were as follows: semiconductor capital equipment, \$8.0 million; data storage, \$5.0 million; flat panel display, \$0.9 million; industrial, \$6.1 million; customer service technical support, \$1.9 million. For the comparable period in 1997, sales by industry were as follows: semiconductor capital equipment, \$23.9 million; data storage, \$7.4 million; flat panel display, \$3.0 million; industrial, \$6.7 million; customer service technical support, \$1.6 million.

Sales by geographic region for the three months ended September 30, 1998 were as follows: United States, \$13.7 million; Europe, \$6.9 million; Japan, \$1.1 million; Pacific Rim and other, \$0.2 million. For the comparable period in 1997, sales by geographic region were as follows: United States, \$31.1 million; Europe, \$6.7 million; Japan, \$3.7 million; Pacific Rim and other, \$1.1 million.

Sales for the third quarter of 1998 were down 16% from second quarter of 1998 sales of \$26.2 million. This decrease was due to decreased demand from semiconductor capital equipment manufacturers in the United States, partially offset by increased demand from data storage equipment manufacturers in Europe and Japan.

GROSS MARGIN

The Company's gross margin for the third quarter of 1998 was 31.6%, down from 40.0% in the third quarter 1997 and up from 26.9% in the second quarter of 1998. The decrease in gross margin from the third quarter of 1997 to the third quarter of 1998 was due primarily to unfavorable absorption of manufacturing overhead, partially offset by lower material costs.

During the fourth quarter of 1997, the Company expanded into a new manufacturing facility in Fort Collins, Colorado. In the second quarter of 1998, the Company relocated part of its previously existing Fort Collins manufacturing operations to a new facility in Austin, Texas. The expansion to new locations was to provide service to one of the Company's major customers whose primary manufacturing facilities are in Austin, and to accommodate the anticipated growth of the semiconductor industry. Beginning late in the fourth quarter of 1997, the semiconductor industry started a downturn, which has continued through the third quarter of 1998. The downturn in this industry with the resulting underutilization of capacity has significantly impacted the Company's financial results. The combination of the expansion and lower sales has resulted in an over-capacity situation for the Company, leading to unfavorable absorption of manufacturing overhead and a substantially reduced gross margin.

The Company initiated cost reduction measures during the first quarter of 1998, including a 10% reduction in executive salaries and certain scheduled mandatory time off

for all personnel, except those in critical functions. These cost reduction measures were continued into the third quarter of 1998 and will be continued through at least the fourth quarter of 1998. Also, the Company implemented other cost-reducing initiatives during the third quarter of 1998, including the closure of one warehouse facility in Fort Collins, Colorado (see "One-time Charges" below). The Company expects that underutilization of manufacturing capacity will continue to negatively impact gross margins until sales to the semiconductor capital equipment market recover or until other markets the Company serves experience significant growth.

The increase in gross margin from the second quarter of 1998 to the third quarter of 1998 was due primarily to reduced material costs.

RESEARCH AND DEVELOPMENT

The Company's research and development expenses are incurred researching new technologies, developing new products and improving existing product designs. Research and development expenses for the third quarter of 1998 were \$4.4 million, an increase of 9% from \$4.1 million in the comparable period in 1997. The increase in expenses was attributable to increased spending for payroll for new product development, and to higher infrastructure costs. As a percentage of sales, research and development expenses increased to 20.2% in the third quarter of 1998 from 9.6% in the third quarter of 1997, reflecting the lower sales base.

The Company believes continued research and development investment for development of new products is critical to the Company's ability to serve new and existing markets. Since inception, all research and development costs have been internally funded and expensed.

SALES AND MARKETING

Sales and marketing expenses support domestic and international sales and marketing activities that include personnel, trade shows, advertising, and other marketing activities. Sales and marketing expenses for the third quarter of 1998 were \$2.8 million, compared to \$2.3 million in the third quarter of 1997, representing an increase of 19%. The increase was attributable to higher payroll costs incurred as the Company continues to increase its sales management and product management capabilities. Additionally, the Company increased spending in 1998 to develop worldwide applications engineering capabilities. As a percentage of sales, sales and marketing expenses increased to 12.7% in the third quarter of 1998 from 5.5% in the third quarter of 1997, reflecting the lower sales base.

GENERAL AND ADMINISTRATIVE

General and administrative expenses support the worldwide financial, administrative, information systems and human resources functions of the Company. General and administrative expenses for the third quarter of 1998 were \$1.8 million, compared to \$1.9

million in the third quarter of 1997, representing a decrease of 9%. As a percentage of sales, general and administrative expenses increased to 8.1% in the third quarter of 1998 from 4.6% in the third quarter of 1997, reflecting the lower sales base.

The Company continues to implement its management system software, including the replacement of existing systems in its domestic and foreign locations. The Company expects that charges related to training and implementation of the software will continue through 1998.

ONE-TIME CHARGES

On August 13, 1998 the Company announced a restructuring plan to respond to a downturn in the semiconductor capital equipment business. The plan included a reduction in workforce of 128 people and the closure of one facility in the Company's Fort Collins, Colorado campus. Additionally, the Company abandoned plans to construct a new facility in Fort Collins, Colorado. The Company took a one-time charge of \$1.0 million for the restructuring in the third quarter of 1998.

In the third quarter of 1997, the Company took one-time charges totaling \$6.1 million. Included were a charge of \$3.0 million for storm damage to the Company's headquarters and main manufacturing facilities, and \$3.1 million for purchased in-process research and development as part of the acquisition of Tower.

OTHER INCOME (EXPENSE)

Other income (expense) consists primarily of foreign exchange gains and losses, interest income and expense and other non-operating expenses. Other expense for the third quarter of 1998 was \$0.2 million, attributable primarily to \$0.3 million for a writedown of a stock investment. In the comparable period in 1997, other income was \$0.1 million.

The Company experienced fluctuations in foreign currency exchange rates during 1997 and the first nine months of 1998, particularly against the Japanese yen. As a hedge against currency fluctuations in the yen, the Company entered into various forward foreign exchange contracts during 1997 and 1998 to mitigate the effect of potential depreciation in that currency. The Company continues to evaluate various policies to minimize the effects of currency fluctuations.

PROVISION FOR INCOME TAXES

The income tax benefit of \$1.1 million for the third quarter of 1998 represented an estimated effective rate of 33.3%, compared to an effective income tax rate for the year 1997 of 39.2%. The higher effective tax rate for 1997 was attributed to nondeductible charges resulting from the acquisition of Tower. The lower effective tax rate in 1998 is due to losses recorded at the Company's subsidiary in Japan in which no tax benefit has

been recorded. The Company adjusts its provision for income taxes periodically, based upon the anticipated tax status of all of its foreign and domestic entities.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

SALES

Sales for the first nine months of 1998 were \$84.8 million, a decrease of 12% from sales of \$95.9 million in the comparable period in 1997. Sales to the semiconductor capital equipment market in the United States were significantly lower. Sales to the data storage equipment market decreased moderately while sales to the flat panel display market decreased significantly, primarily due to the Asian financial crisis. Sales to industrial markets increased significantly, due primarily to sales by Tower. Sales to customers in Europe were higher while sales to the United States, Japan and other geographic regions were lower.

Sales by industry segment for the nine months ended September 30, 1998 were as follows: semiconductor capital equipment, \$40.8 million; data storage, \$14.2 million; flat panel display, \$4.0 million; industrial, \$21.4 million; customer service technical support, \$4.4 million. For the comparable period in 1997, sales by industry were as follows: semiconductor capital equipment, \$56.8 million; data storage, \$16.1 million; flat panel display, \$6.6 million; industrial, \$12.9 million; customer service technical support, \$3.5 million.

Sales by geographic region for the nine months ended September 30, 1998 were as follows: United States, \$60.0 million; Europe, \$18.6 million; Japan, \$4.7 million; Pacific Rim and other, \$1.5 million. For the comparable period in 1997, sales by geographic region were as follows: United States, \$70.0 million; Europe, \$14.5 million; Japan, \$8.9 million; Pacific Rim and other, \$2.5 million.

GROSS MARGIN

The Company's gross margin for the first nine months of 1998 was 29.6%, down from 38.7% in the comparable period in 1997. The decrease in gross margin between the periods presented was due primarily to unfavorable absorption of manufacturing overhead and higher material costs in the first half of 1998. The unfavorable absorption resulted from underutilized capacity resulting from additional manufacturing and warehouse facilities the Company opened between the periods presented, including two in Fort Collins, Colorado during the fourth quarter of 1997 and one in Austin, Texas, during the second quarter of 1998. The higher material costs are a result of a shift in the mix of the products the Company sells. As part of its restructuring, the Company closed one of its six facilities in its Fort Collins, Colorado campus during the third quarter of 1998.

RESEARCH AND DEVELOPMENT

Research and development expenses for the first nine months of 1998 were \$13.9 million, up from \$10.4 million in the comparable period in 1997. The increase was attributable to higher spending for payroll, materials and supplies, purchased services and higher infrastructure costs for new product development. As a percentage of sales, research and development expenses increased to 16.3% in the first nine months of 1998 from 10.8% in the comparable period in 1997, reflecting the lower sales base.

SALES AND MARKETING

Sales and marketing expenses for the first nine months of 1998 were \$8.7 million, up from \$6.5 million in the comparable period in 1997. The increase was attributable to higher spending for payroll to strengthen the Company's sales management and product management teams. As a percentage of sales, sales and marketing expenses increased to 10.2% in the first nine months of 1998 from 6.7% in the comparable period in 1997, reflecting the lower sales base.

GENERAL AND ADMINISTRATIVE

General and administrative expenses for the first nine months of 1998 were \$5.8 million, up from \$4.9 million in the comparable period in 1997. The increase was attributable to amortization of goodwill and higher spending for payroll. As a percentage of sales, general and administrative expenses increased to 6.9% in the first nine months of 1998 from 5.1% in the comparable period in 1997, reflecting the lower sales base.

OTHER INCOME (EXPENSE)

Other income for the first nine months of 1998 was \$0.2 million, attributable primarily to \$0.8 million of interest income from marketable securities, offset by the writedown of a stock investment of \$0.3 million and \$0.3 million of other expense.

PROVISION FOR INCOME TAXES

The income tax benefit of \$1.4 million for the first nine months of 1998 represented an estimated effective rate of 34.3% compared to an effective income tax rate for the year 1997 of 39.2%. The lower tax rate in 1998 when compared to 1997 is due to losses incurred in Japan in which no tax benefit has been recorded.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, the Company has financed its operations, acquired equipment and met its working capital requirements through cash flow from operations, borrowings

under its revolving line of credit, long-term loans secured by property and equipment, and, since November 1995, proceeds from underwritten public offerings.

Operations provided cash of \$7.6 million in the first nine months of 1998, primarily as a result of depreciation, amortization, and decreases in accounts receivable and inventories, partially offset by net loss, decreases in accounts payable and decreased accruals for payroll, employee benefits and income taxes. In the comparable period in 1997, operations provided cash of \$0.8 million, primarily as a result of net income plus non-cash expenses affecting net income, and increases in accounts payable and other accruals, offset by increases in accounts receivable and inventories.

Investing activities used cash of \$6.1 million in the first nine months of 1998, and included the purchase of property and equipment for \$4.1 million, the purchase of assets of FST for \$2.5 million, and investment in preferred stock of Litmas, Inc. ("Litmas") for \$1.0 million. In the comparable period in 1997, investing activities used cash of \$14.8 million and included the acquisition of Tower for \$12.1 million and the purchase of property and equipment for \$2.7 million.

Financing activities in the first nine months of 1998 used cash of \$2.9 million and consisted primarily of net changes of notes payable and capital lease obligations [\$3.3 million]. Financing activities in the comparable period in 1997 provided cash of \$12.1 million and consisted primarily of short-term borrowings undertaken in connection with the purchase of Tower [\$12.0 million], and capital lease obligations and proceeds from notes receivable.

The Company plans to spend approximately \$0.7 million through the remainder of 1998 for the acquisition of manufacturing and test equipment and furnishings.

As of September 30, 1998, the Company had working capital of \$60.3 million. The Company's principal sources of liquidity consisted of \$10.0 million of cash and cash equivalents, \$19.2 million of marketable securities, and a credit facility consisting of a \$30.0 million revolving line of credit, with options to convert up to \$10.0 million to a three-year term loan. Advances under the revolving line of credit bear interest at either the prime rate (8.00% at October 31, 1998) minus 1.25% or the LIBOR 360-day rate (4.75125% at October 31, 1998) plus 150 basis points, at the Company's option. All advances under the revolving line of credit will be due and payable in December 2003; however, there were no advances outstanding as of September 30, 1998.

The Company believes that its cash and cash equivalents, marketable securities, cash flow from operations and available borrowings, will be sufficient to meet the Company's working capital needs through the end of 1998. After that time, the Company may require additional equity or debt financing to address its working capital, capital equipment, or expansion needs. In addition, any significant acquisitions by the Company may require additional equity or debt financings 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 the Company.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not aware of any material legal proceedings to which it or any of its subsidiaries is a party.

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

Not applicable.

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(1) |
| 3.2 | The Company's Bylaws(1) |
| 4.1 | Form of Specimen Certificate for the Company's Common Stock(1) |
| 4.2 | The Company hereby agrees to furnish to the SEC, upon request, a copy of the instruments which define the rights of holders of long-term debt of the Company. None of such instruments not included as exhibits herein represents long-term debt in excess of 10% of the consolidated total assets of the Company. |
| 10.1 | Comprehensive Supplier Agreement, dated May 18, 1998, between Applied Materials Inc., and the Company(2)+ |

- 10.2 Purchase Order and Sales Agreement, dated July 1, 1993, amended September 16, 1995 between Lam Research Corporation and the Company(1)+
- 10.3 Purchase Agreement, dated November 1, 1995, between Eaton Corporation and the Company(3)+
- 10.4 Loan and Security Agreement, dated August 15, 1997, among Silicon Valley Bank, Bank of Hawaii and the Company(4)
- 10.5 Loan Agreement dated December 8, 1997, by and among Silicon Valley Bank, as Servicing Agent and a Bank, and Bank of Hawaii, as a Bank, and the Company, as borrower(5)
- 10.6 Lease, dated June 12, 1984, amended June 11, 1992, between Prospect Park East Partnership and the Company for property in Fort Collins, Colorado(1)
- 10.7 Lease, dated March 14, 1994, as amended, between Sharp Point Properties, L.L.C., and the Company for property in Fort Collins, Colorado(1)
- 10.8 Lease, dated May 19, 1995, between Sharp Point Properties, L.L.C. and the Company for a building in Fort Collins, Colorado(1)
- 10.9 Lease, dated April 15, 1998, between Cross Park Investors, Ltd., and the Company for property in Austin, Texas(2)
- 10.10 Lease, dated April 15, 1998, between Cameron Technology Investors, Ltd., and the Company for property in Austin, Texas(2)
- 10.11 Form of Indemnification Agreement(1)
- 10.12 1995 Stock Option Plan, as amended and restated(5)*
- 10.13 Employee Stock Purchase Plan(1)*
- 10.14 1995 Non-Employee Directors' Stock Option Plan(1)*
- 27.1 Financial Data Schedule for the nine-month period ended September 30, 1998.

(b) No reports on Form 8-K were filed or required to be filed by the Company during the quarter ended September 30, 1998.

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

(2) Incorporated by reference to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 1998 (File No. 0-26966), filed August 7, 1998.

(3) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1995 (File No. 0-26966), filed March 28, 1996, as amended.

(4) Incorporated by reference to the Company's Registration Statement on Form S-3 (File No. 333-34039), filed August 21, 1997, as amended.

(5) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1997 (File No. 0-26966), filed March 24, 1998.

* Compensation Plan

+ Portions of these documents have been omitted in accordance with an order by the SEC granting confidential treatment. Such omitted material has been filed separately with the SEC.

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/ Richard P. Beck

Senior Vice President, Chief Financial Officer, Assistant Secretary and Director (Principal Financial Officer and Principal Accounting Officer) *November 12, 1998*

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ARTICLE 5

MULTIPLIER: 1,000

PERIOD TYPE	9 MOS
FISCAL YEAR END	DEC 31 1998
PERIOD START	JUL 01 1998
PERIOD END	SEP 30 1998
CASH	9,985
SECURITIES	19,218
RECEIVABLES	17,042
ALLOWANCES	(467)
INVENTORY	19,023
CURRENT ASSETS	70,063
PP&E	22,392
DEPRECIATION	(9,610)
TOTAL ASSETS	94,791
CURRENT LIABILITIES	9,813
BONDS	0
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	23
OTHER SE	84,955
TOTAL LIABILITY AND EQUITY	94,791
SALES	84,755
TOTAL REVENUES	84,755
CGS	59,652
TOTAL COSTS	59,652
OTHER EXPENSES	29,379
LOSS PROVISION	0
INTEREST EXPENSE	134
INCOME PRETAX	(4,086)
INCOME TAX	(1,403)
INCOME CONTINUING	(2,683)
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	(2,683)
EPS PRIMARY	(0.12)
EPS DILUTED	(0.12)

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