

ADVANCED ENERGY INDUSTRIES INC

Form 10-Q

August 07, 2014

Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended June 30, 2014

or

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.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

1625 Sharp Point Drive, Fort Collins, CO

(Address of principal executive offices)

84-0846841

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

80525

(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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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As of July 31, 2014 there were 39,934,085 shares of the registrant's Common Stock, par value \$0.001 per share, outstanding.

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ADVANCED ENERGY INDUSTRIES, INC.  
FORM 10-Q  
TABLE OF CONTENTS

	Page
<u>PART I FINANCIAL STATEMENTS</u>	<u>3</u>
<u>ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>24</u>
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>32</u>
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	<u>32</u>
<u>PART II OTHER INFORMATION</u>	<u>34</u>
<u>ITEM 1. LEGAL PROCEEDINGS</u>	<u>34</u>
<u>ITEM 1A. RISK FACTORS</u>	<u>34</u>
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>34</u>
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	<u>35</u>
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	<u>35</u>
<u>ITEM 5. OTHER INFORMATION</u>	<u>35</u>
<u>ITEM 6. EXHIBITS</u>	<u>36</u>
<u>SIGNATURES</u>	<u>37</u>
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	

Table Of Contents

## PART I FINANCIAL STATEMENTS

## ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## ADVANCED ENERGY INDUSTRIES, INC.

## Condensed Consolidated Balance Sheets \*

(In thousands, except per share amounts)

	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 117,549	\$ 138,125
Marketable securities	12,633	11,568
Accounts receivable, net of allowances of \$4,236 and \$2,920, respectively	121,262	125,782
Inventories, net of reserves of \$20,566 and \$15,349, respectively	118,187	109,771
Deferred income tax assets	10,755	10,746
Income taxes receivable	4,760	10,027
Other current assets	13,084	10,950
Total current assets	398,230	416,969
Property and equipment, net	32,821	34,888
<b>OTHER ASSETS:</b>		
Deposits and other	2,478	2,421
Goodwill	206,863	157,800
Other intangible assets, net	44,755	19,411
Deferred income tax assets	19,000	21,488
Total assets	\$ 704,147	\$ 652,977
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 72,210	\$ 55,623
Income taxes payable	1,299	2,324
Accrued payroll and employee benefits	9,321	12,892
Accrued warranty expense	18,545	10,198
Other accrued expenses	25,542	20,704
Customer deposits	8,131	6,955
Notes payable	4,647	13,661
Total current liabilities	139,695	122,357
<b>LONG-TERM LIABILITIES:</b>		
Deferred income tax liabilities	3,956	1,500
Uncertain tax positions	6,376	5,781
Accrued warranty expense	19,045	11,869
Long term deferred revenue	45,722	43,171
Other long-term liabilities	24,391	3,837
Total liabilities	239,185	188,515
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none issued and outstanding	—	—
Common stock, \$0.001 par value, 70,000 shares authorized; 39,888 and 40,503 issued and outstanding, respectively	40	41
Additional paid-in capital	228,350	251,550
Retained earnings	204,775	179,414

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Accumulated other comprehensive income	31,797	33,457
Total stockholders' equity	464,962	464,462
Total liabilities and stockholders' equity	\$704,147	\$652,977

\* Amounts as of June 30, 2014 are unaudited.

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

3

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Table Of Contents

ADVANCED ENERGY INDUSTRIES, INC.  
Condensed Consolidated Statements of Operations (Unaudited)  
(In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
SALES	\$146,285	\$139,711	\$287,233	\$251,525
COST OF SALES	93,739	86,452	182,026	156,427
GROSS PROFIT	52,546	53,259	105,207	95,098
OPERATING EXPENSES:				
Research and development	15,736	15,740	29,878	29,993
Selling, general and administrative	22,828	22,910	42,559	40,564
Amortization of intangible assets	2,226	1,975	4,101	4,188
Restructuring charges and asset impairment	244	24,206	244	24,206
Total operating expenses	41,034	64,831	76,782	98,951
OPERATING INCOME (LOSS)	11,512	(11,572)	28,425	(3,853)
OTHER INCOME (EXPENSE), NET	25	(330)	(71)	(533)
Income (loss) before income taxes	11,537	(11,902)	28,354	(4,386)
Provision (benefit) for income taxes	891	(2,120)	2,993	(1,430)
NET INCOME (LOSS)	\$10,646	\$(9,782)	\$25,361	\$(2,956)
Basic weighted-average common shares outstanding	40,540	39,453	40,677	39,114
Diluted weighted-average common shares outstanding	41,147	40,150	41,419	39,899
EARNINGS (LOSS) PER SHARE:				
BASIC EARNINGS (LOSS) PER SHARE	\$0.26	\$(0.25)	\$0.62	\$(0.08)
DILUTED EARNINGS (LOSS) PER SHARE	\$0.26	\$(0.24)	\$0.61	\$(0.07)

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table Of Contents

## ADVANCED ENERGY INDUSTRIES, INC.

## Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(In thousands)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net income (loss)	\$10,646	\$(9,782 )	\$25,361	\$(2,956 )
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	3	(690 )	(1,661 )	(3,524 )
Unrealized gains (losses) on marketable securities	(1 )	—	1	(7 )
Comprehensive income (loss)	\$10,648	\$(10,472 )	\$23,701	\$(6,487 )

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table Of Contents

ADVANCED ENERGY INDUSTRIES, INC.  
Condensed Consolidated Statements of Cash Flows (Unaudited)  
(In thousands)

	Six Months Ended June 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$25,361	\$(2,956)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	10,326	10,592
Stock-based compensation expense	3,259	5,204
Provision for deferred income taxes	2,481	4,117
Restructuring charges and asset impairment	—	24,206
Net gain on sale or disposal of assets	873	312
Changes in operating assets and liabilities, net of assets acquired:		
Accounts receivable	7,577	(39,601)
Inventories	(3,374)	(3,561)
Other current assets	3,189	66
Accounts payable	13,063	8,243
Other current liabilities and accrued expenses	(20,451)	(2,224)
Income taxes	4,769	(14,410)
Net cash provided by (used in) operating activities	47,073	(10,012)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of marketable securities	(5,402)	(13,056)
Proceeds from sale of marketable securities	4,315	26,613
Purchases of property and equipment	(3,453)	(3,825)
Acquisitions, net of cash acquired	(26,938)	(77,211)
Net cash used in investing activities	(31,478)	(67,479)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Borrowings from lines of credit, net of repayments	(9,044)	1,555
Settlement of performance stock units	(11,198)	—
Purchase and retirement of common stock	(25,000)	—
Proceeds from exercise of stock options	8,920	16,937
Excess tax from stock-based compensation deduction	818	(678)
Other financing activities	(5)	(52)
Net cash provided by (used in) financing activities	(35,509)	17,762
EFFECT OF CURRENCY TRANSLATION ON CASH	(662)	227
DECREASE IN CASH AND CASH EQUIVALENTS	(20,576)	(59,502)
CASH AND CASH EQUIVALENTS, beginning of period	138,125	146,564
CASH AND CASH EQUIVALENTS, end of period	\$117,549	\$87,062
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid for interest	\$102	\$26
Cash paid for income taxes	948	13,895
Cash received for refunds of income taxes	5,034	2,929
Cash held in banks outside the United States of America	53,531	30,739

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.





Table Of Contents

ADVANCED ENERGY INDUSTRIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

Advanced Energy Industries, Inc., a Delaware corporation, and its wholly-owned subsidiaries ("we," "us," "our," "Advanced Energy," or the "Company") design, manufacture, sell, and support power conversion and control products that transform power into various usable forms. Our products enable manufacturing processes that use thin film deposition for various products, such as semiconductor devices, flat panel displays, thin film renewables, and architectural glass. We also supply thermal instrumentation products for advanced temperature control in the thin film process for these same markets. Our power control modules provide power control solutions for industrial applications where heat treatment and processing are used such as glass manufacturing, metal fabrication and treatment, material and chemical processing. Our solar inverter products support renewable power generation solutions primarily for commercial, and utility-scale solar projects and installations. Our network of global service support centers provides a recurring revenue opportunity as we offer repair services, conversions, upgrades, and refurbishments to companies using our products. We also offer a wide variety of operations and maintenance service plans that can be tailored for photovoltaic ("PV") sites of all sizes.

We are organized into two strategic business units based on the products and services provided.

Precision Power Products strategic business unit ("Precision Power Products") offers products for direct current ("DC"), pulsed DC mid-frequency, high voltage, and radio frequency ("RF") power supplies, matching networks and RF instrumentation as well as thermal instrumentation and digital power controller products.

Inverters strategic business unit ("Inverters SBU") offers both a transformer-based or transformerless advanced grid-tied PV inverter solution for commercial and utility-scale system installations. Our PV inverters are designed to convert renewable solar power, drawn from large and small scale solar arrays, into high quality, reliable electrical power.

In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements contain all adjustments, consisting of normal, recurring adjustments, necessary to present fairly the financial position of the Company at June 30, 2014, and the results of our operations and cash flows for the three and six months ended June 30, 2014 and 2013.

The Condensed Consolidated Financial Statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted pursuant to such rules and regulations. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 and other financial information filed with the SEC.

ESTIMATES AND ASSUMPTIONS

The preparation of our Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires us to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We believe that the significant estimates, assumptions, and judgments when accounting for items and matters such as allowances for doubtful accounts, excess and obsolete inventory, warranty reserves, acquisitions, asset valuations, goodwill, asset life, depreciation, amortization, recoverability of assets, impairments, deferred revenue, stock option and restricted stock grants, taxes, and other provisions are reasonable, based upon information available at the time they are made. Actual results may differ from these estimates, making it possible that a change in these estimates could occur in the near term.

CRITICAL ACCOUNTING POLICIES

Our accounting policies are described in our audited Consolidated Financial Statements and Notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2013.



Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## NEW ACCOUNTING STANDARDS

From time to time, the Financial Accounting Standards Board ("FASB") or other standards setting bodies issue new accounting pronouncements. Updates to the FASB Accounting Standards Codification ("ASC") are communicated through issuance of an Accounting Standards Update ("ASU"). Unless otherwise discussed, we believe that the impact of recently issued guidance, whether adopted or to be adopted in the future, is not expected to have a material impact on the Condensed Consolidated Financial Statements upon adoption.

In May 2014, the FASB issued guidance on revenue from contracts with customers, which implements a five step process of how an entity should recognize revenue in order to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective at the beginning of fiscal year 2017, and early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are currently evaluating the impact that the adoption will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing reporting.

## NOTE 2. BUSINESS ACQUISITIONS

## Acquisitions

## Refusol Holding

On April 8, 2013, we acquired all the outstanding shares of Refusol Holding GmbH pursuant to a Sale and Purchase Agreement (the "Agreement") between AEI Holdings, GmbH (formerly Blitz S13-103, GmbH) ("AEI Holdings"), an indirect wholly-owned subsidiary of Advanced Energy Industries, Inc.; Jolaos Verwaltungs GmbH ("Jolaos") and Prettl Beteiligungs Holding GmbH. Refusol Holding GmbH ("Refusol Holding") owns all of the shares of Refusol GmbH and its subsidiaries (collectively and together with Refusol Holding, "Refusol"). Refusol develops, manufactures, distributes and services photovoltaic inverters. The acquisition of Refusol is intended to broaden our portfolio and extend our geographic distribution.

Consideration paid totaled approximately \$87.2 million, consisting of a cash payment of \$75.4 million, net of cash acquired and a working capital reduction and assumption of debt totaling \$11.9 million. The agreement called for additional cash consideration if certain stretch financial targets were met by our Inverters business unit and Refusol, on a combined basis, at the end of the twelve (12) calendar months following April 1, 2013. These financial targets were not met.

The preliminary base price is subject to a post-closing adjustment based on confirmation of the financial statements of Refusol effective as of the closing date. AEI Holdings and Jolaos are in disagreement on various accounting adjustments to the closing date financial statements of Refusol. After repeated unsuccessful attempts to have Jolaos submit the dispute to an independent German accounting firm as required under the Agreement, AEI Holdings petitioned the designated court in Stuttgart, Germany to review the dispute.

The components of the fair value of the total consideration transferred for the Refusol acquisition are as follows (in thousands):

Cash paid to owners	\$79,550	
Debt assumed	11,873	
Working capital adjustment	(2,340)	)
Cash acquired	(1,836)	)
Total fair value of consideration transferred	\$87,247	

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes estimated fair values of the assets acquired and liabilities assumed as of April 8, 2013 (in thousands):

Accounts receivable	\$8,868	
Inventories	13,610	
Other current assets	6,769	
Property and equipment	4,708	
Other long-term assets	130	
Deferred tax assets	(3,156)	)
Current liabilities	(33,397)	)
Long-term liabilities	(41,646)	)
	(44,114)	)
Amortizable intangible assets:		
Trademarks	1,300	
Technology	5,700	
Customer relationships	3,500	
Total amortizable intangible assets	10,500	
Total identifiable net assets	(33,614)	)
Goodwill	120,861	
Total fair value of consideration transferred	\$87,247	

A summary of the intangible assets acquired, amortization method and estimated useful lives as of April 8, 2013 follows (in thousands, except useful life):

	Amount	Amortization Method	Useful Life
Trademarks	\$1,300	Straight-line	1.5
Technology	5,700	Straight-line	5
Customer relationships	3,500	Straight-line	5
	\$10,500		

During the six months ended June 30, 2014 we made purchase price accounting adjustments to Goodwill of \$29.4 million, primarily consisting of adjustments to the opening balance of accrued warranty and other accrued expenses. Goodwill and intangible assets are recorded in the functional currency of the entity and are subject to changes due to translation at each balance sheet date. The goodwill associated with the acquisition is the result of expected synergies and expansion of the technology into additional markets that we already serve.

**Pro Forma Results for Refusol Acquisition**

The following unaudited pro forma financial information presents the combined results of operations of Advanced Energy and Refusol as if the acquisition had occurred as of January 1, 2013. The pro forma financial information is presented for informational purposes and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at January 1, 2013. The unaudited pro forma financial information for the three and six months ended June 30, 2013 includes the historical results of Advanced Energy for the three and six months ended June 30, 2013 and the historical results of Refusol for the same period.

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The unaudited pro forma results for all periods presented include amortization charges for acquired intangible assets and related tax effects. The unaudited pro forma results follow (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Sales	\$ 146,285	\$ 140,154	\$ 287,233	\$ 271,608
Net income (loss)	10,646	(10,414 )	25,361	(7,662 )
Earnings (loss) per share:				
Basic	\$0.26	\$(0.26 )	\$0.62	\$(0.20 )
Diluted	\$0.26	\$(0.26 )	\$0.61	\$(0.19 )

**Power Control Module**

On January 27, 2014, we acquired the intellectual property related to AEG Power Solutions' Power Control Modules ("PCM"). PCM is comprised of the Thyro-Family of products and accessories and serves numerous power control applications in different industries ranging from materials thermal processing through chemical processing, glass manufacturing and numerous other general industrial power applications. This acquisition is expected to broaden our product offerings and will be added to our Precision Power Products SBU. We paid total consideration of \$31.1 million including contingent consideration, of which \$16.4 million is included in Intangibles, \$14.6 million in Goodwill, and \$0.1 million in Property, plant, and equipment. Included in Goodwill is \$1.0 million of contingent consideration payable if certain milestone targets are met. Goodwill and intangible assets are recorded in the functional currency of the entity and are subject to changes due to translation at each balance sheet date. The goodwill associated with the acquisition is the result of expected synergies and expansion of our product offerings into new markets. Advanced Energy is in the process of finalizing valuations of the intangibles associated with the acquisition.

**HiTek Power Group**

On April 12, 2014, Advanced Energy acquired all outstanding common stock of HiTek Power Group ("HiTek"), a privately-held provider of high voltage power solutions. Based in the United Kingdom, HiTek offers a comprehensive portfolio of high voltage and custom built power conversion products, ranging from 100V to 500kV, designed to meet the demanding requirements of OEMs worldwide. These products target applications including semiconductor wafer processing and metrology, scientific instrumentation, mass spectrometry, industrial printing, and analytical x-ray systems for industrial and analytical applications. HiTek's unique product architecture, encapsulation technology and control algorithms, combined with deep knowledge of its customer-specific applications, have made it a leading provider of critical, high-end, high voltage power solutions. We acquired HiTek to expand our product offerings in our Precision Power Products portfolio.

The components of the fair value of the total consideration transferred for the HiTek acquisition are as follows (in thousands):

Cash paid to owners		\$3,525	
Cash acquired		(6,889	)
Total fair value of consideration received		\$ (3,364	)

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes estimated fair values of the assets acquired and liabilities assumed as of April 12, 2014 (in thousands):

Accounts receivable	\$2,867	
Inventories	4,980	
Other current assets	415	
Property and equipment	1,291	
Current liabilities	(3,836	)
Long-term liabilities	(22,725	)
	(17,008	)
Amortizable intangible assets:		
Tradenname	336	
Technology	4,029	
Customer relationships	8,225	
Total amortizable intangible assets	12,590	
Total identifiable net assets	(4,418	)
Goodwill	1,054	
Total fair value of consideration received	\$(3,364	)

Goodwill and intangible assets are recorded in the functional currency of the entity and are subject to changes due to translation at each balance sheet date. The goodwill associated with the acquisition is the result of expected synergies and expansion of the technology into additional markets that we already serve. Advanced Energy is in the process of finalizing the valuations of the accounts receivable, inventories, property, plant and equipment, intangibles, deferred taxes, and pension liability associated with the acquisition.

## NOTE 3. INCOME TAXES

The following table sets out the tax expense and the effective tax rate for our income from continuing operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Income (loss) before income taxes	\$ 11,537	\$(11,902 )	\$ 28,354	\$(4,386 )
Provision (benefit) for income taxes	891	(2,120 )	2,993	(1,430 )
Effective tax rate	7.7	% 17.8	% 10.6	% 32.6 %

The effective tax rates for the three and six months ended June 30, 2014 differ from the federal statutory rate of 35% primarily due to the benefit of earnings in foreign jurisdictions which are subject to lower tax rates. The effective tax rate is also impacted by discrete items recorded in the period. The effective tax rate for the period does not reflect the benefit for the US research and development tax credit which expired December 31, 2013. For the three and six months ended June 30, 2013, the effective tax rate reflected benefits attributable to restructuring expenses and the January 2, 2013 reinstatement of the 2012 US research and development tax credit.

Our policy is to classify accrued interest and penalties related to unrecognized tax benefits in our income tax provision. For the three and six months ended June 30, 2014 and 2013, the amount of interest and penalties accrued related to our unrecognized tax benefits was not significant.

## NOTE 4. EARNINGS PER SHARE

Basic earnings per share ("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 numerator is increased to exclude charges that would not have been incurred, and the denominator is increased to include the number of additional common shares that would have been outstanding (using the if-converted and





Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

treasury stock methods), if securities containing potentially dilutive common shares (e.g., stock options and restricted stock units) had been converted to common shares, and if such assumed conversion is dilutive.

The following is a reconciliation of the weighted-average shares outstanding used in the calculation of basic and diluted EPS (in thousands, except per share data):

	Three Months Ended		Six Months Ended June	
	June 30, 2014	2013	30, 2014	2013
Net Income (loss)	\$10,646	\$(9,782)	\$25,361	\$(2,956)
Basic weighted-average common shares outstanding	40,540	39,453	40,677	39,114
Assumed exercise of dilutive stock options and restricted stock units	607	697	742	785
Diluted weighted-average common shares outstanding	41,147	40,150	41,419	39,899
Net Income (loss):				
Basic earnings (loss) per share	\$0.26	\$(0.25)	\$0.62	\$(0.08)
Diluted earnings (loss) per share	\$0.26	\$(0.24)	\$0.61	\$(0.07)

The following stock options were excluded in the computation of diluted earnings per share because they were anti-dilutive:

	Three Months Ended		Six Months Ended June	
	June 30, 2014	2013	30, 2014	2013
Stock options	79	695	52	780
Stock Buyback				

In May 2014, our Board of Directors authorized a program to repurchase up to \$25.0 million of our stock over a twelve-month period. Under this program, during the three and six months ended June 30, 2014, we repurchased and retired 1.4 million shares of our common stock for a total of \$25.0 million. As of June 30, 2014 we have completed the share repurchase program.

All shares repurchased were executed in the open market and no shares were repurchased from related parties. Repurchased shares were retired and assumed the status of authorized and unissued shares.

**NOTE 5. MARKETABLE SECURITIES**

Our investments with original maturities of more than three months at time of purchase are considered marketable securities available for sale.

Our marketable securities consist entirely of certificates of deposit as follows (in thousands):

	June 30, 2014		December 31, 2013	
	Cost	Fair Value	Cost	Fair Value
Total marketable securities	\$12,633	\$12,633	\$11,568	\$11,568

The maturities of our marketable securities available for sale as of June 30, 2014 are as follows:

	Earliest	Latest
Certificates of deposit	7/29/2014	to 6/13/2016

The value and liquidity of the marketable securities we hold are affected by market conditions, as well as the ability of the issuers of such securities to make principal and interest payments when due, and the functioning of the markets in which these securities are traded. Our current investments in marketable securities are expected to be liquidated during the next twelve months.

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

As of June 30, 2014, we do not believe any of the underlying issuers of our marketable securities are presently at risk of default.

NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS

We are impacted by changes in foreign currency exchange rates. We attempt to mitigate these risks through the use of derivative financial instruments, primarily forward contracts. During the three and six months ended June 30, 2014 and 2013, we entered into foreign currency exchange forward contracts to attempt to mitigate the exchange rate risk associated with intercompany debt denominated in nonfunctional currencies. These derivative instruments are not designated as hedges; however, they tend to offset the fluctuations of our intercompany debt due to foreign exchange rate changes. These forward contracts are typically for one month periods. At June 30, 2014 we had outstanding Euro forward contracts. At December 31, 2013 we had outstanding Euro, Swiss Franc, and Canadian Dollar forward contracts.

The notional amount of foreign currency exchange contracts at June 30, 2014 and 2013 was \$11.6 million and \$39.0 million, and the difference between the fair value and the notional value of these contracts was not significant. During the three months ended June 30, 2014 and 2013, we recognized an insignificant loss and gain, respectively. For the six months ended June 30, 2014 and 2013, we recognized a loss of \$1.4 million and a gain of \$0.6 million, respectively, on our foreign currency exchange contracts. These losses were offset by corresponding gains on the related intercompany debt and both are included as a component of Other income (expense), net, in our Condensed Consolidated Statements of Operations.

## NOTE 7. ASSETS MEASURED AT FAIR VALUE

The following tables present information about our financial assets measured at fair value, on a recurring basis, as of June 30, 2014, and December 31, 2013. The tables indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value. We did not have any financial liabilities measured at fair value, on a recurring basis, as of June 30, 2014, and December 31, 2013.

June 30, 2014	Level 1 (In thousands)	Level 2	Level 3	Total
Total marketable securities	\$—	\$12,633	\$—	\$12,633
December 31, 2013	Level 1 (In thousands)	Level 2	Level 3	Total
Total marketable securities	\$—	\$11,568	\$—	\$11,568

There were no transfers in or out of Level 1, 2, or 3 fair value measurements during the three and six months ended June 30, 2014.

## NOTE 8. INVENTORIES

Our inventories are valued at the lower of cost or market and computed on a first-in, first-out (FIFO) basis.

Components of Inventories, net of reserves, are as follows (in thousands):

	June 30, 2014	December 31, 2013
Parts and raw materials	\$81,137	\$75,815
Work in process	9,853	3,507
Finished goods	27,197	30,449
Inventories, net of reserves	\$118,187	\$109,771



Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## NOTE 9. PROPERTY AND EQUIPMENT

Details of property and equipment are as follows (in thousands):

	June 30, 2014	December 31, 2013
Buildings and land	\$1,885	\$1,807
Machinery and equipment	47,769	41,451
Computer and communication equipment	24,083	23,117
Furniture and fixtures	4,575	4,028
Vehicles	312	367
Leasehold improvements	27,537	24,369
Construction in process	1,525	5,426
	107,686	100,565
Less: Accumulated depreciation	(74,865	) (65,677
Property and equipment, net	\$32,821	\$34,888

Depreciation expense, recorded in general and administrative expenses and cost of goods sold, is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Depreciation expense	\$3,229	\$3,331	\$6,225	\$6,404

## NOTE 10. GOODWILL

The following summarizes the changes in goodwill during the six months ended June 30, 2014 (in thousands):

Gross carrying amount, beginning of period	\$157,800
Additions (see Note 2)	45,073
Translation adjustments	3,990
Gross carrying amount, end of period	\$206,863

## NOTE 11. INTANGIBLE ASSETS

Other intangible assets consisted of the following as of June 30, 2014 (in thousands, except weighted-average useful life):

	Gross Carrying Amount (net of impairment)	Effect of Changes in Exchange Rates	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life in Years
Amortizable intangibles:					
Technology-based	\$33,508	\$499	\$(16,455	) \$17,552	7
Trademarks and other	32,633	773	(6,203	) 27,203	10
Total amortizable intangibles	\$66,141	\$1,272	\$(22,658	) \$44,755	

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Other intangible assets consisted of the following as of December 31, 2013 (in thousands, except weighted-average useful life):

	Gross Carrying Amount	Effect of Changes in Exchange Rates	Impairment	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life in Years
Amortizable intangibles:						
Technology-based	\$50,368	\$441	\$(26,168)	\$(14,712)	\$9,929	4
Trademarks and other	18,515	514	(5,705)	(3,842)	9,482	7
Total amortizable intangibles	\$68,883	\$955	\$(31,873)	\$(18,554)	\$19,411	

Amortization expense relating to other intangible assets included in our income (loss) is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Amortization expense	\$2,226	\$1,975	\$4,101	\$4,188

Amortization expense related to intangibles for each of the five years 2014 (remaining) through 2018 and thereafter is as follows (in thousands):

Year Ending December 31,	
2014 (remaining)	\$3,858
2015	6,960
2016	5,691
2017	5,509
2018	4,039
Thereafter	18,698
	\$44,755

## NOTE 12. OTHER ACCRUED EXPENSES

Other accrued expenses consisted of the following (in thousands):

	June 30, 2014	December 31, 2013
Other accrued expenses:		
Current deferred tax liability	\$7,910	\$4,519
Accrued restructuring costs (See Note 13)	1,079	3,280
Current contingent consideration	1,444	933
Accrued sales and use tax	3,476	2,415
Goods received not yet invoiced	1,308	—
Other*	10,325	9,557
Total Other accrued expenses	\$25,542	\$20,704

\*Other accrued expenses consists of items that are individually less than 5% of total current liabilities.

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## NOTE 13. RESTRUCTURING COSTS

In April 2014, we committed to a restructuring plan to take advantage of additional cost savings opportunities in connection with our acquisitions and realignment to a single organizational structure based on product line. The plan calls for consolidating certain facilities and rebranding of products which will allow us to use our resources more efficiently. Over the next six months, we plan to incur additional charges of approximately \$2.0 million. Accrued restructuring costs are included in Other accrued liabilities on our Condensed Consolidated Balance Sheet.

The following table summarizes the components of our restructuring costs incurred under the 2014 plan (in thousands):

	Three and Six Months Ended June 30, 2014
Severance and related costs	\$237
Facility closure costs	7
Total restructuring charges	\$244

The following table summarizes our restructuring liabilities under the 2014 plan (in thousands):

	Balances at December 31, 2013	Costs incurred and charged to expense	Cost paid or otherwise settled	Effect of change in exchange rates	Balances at June 30, 2014
Severance and related costs	\$—	\$237	\$(187)	) \$—	\$50
Facility closure costs	—	7	—	—	7
Total restructuring liabilities	\$—	\$244	\$(187)	) \$—	\$57

In April 2013, we committed to a restructuring plan to take advantage of additional cost saving opportunities in connection with our acquisition of Refusol. The plan called for consolidating certain facilities, further centralizing our manufacturing and rationalizing certain products to most effectively meet customer needs. Collectively, these steps will enable us to more efficiently use our resources to achieve strategic goals. All activities under this restructuring plan were completed prior to December 31, 2013.

The following table summarizes our restructuring liabilities under the 2013 plan (in thousands):

	Balances at December 31, 2013	Costs incurred and charged to expense	Cost paid or otherwise settled	Effect of change in exchange rates	Balances at June 30, 2014
Severance and related costs	\$2,078	\$—	\$(1,815)	) \$4	\$267
Facility closure costs	571	—	(379)	) —	192
Total restructuring liabilities	\$2,649	\$—	\$(2,194)	) \$4	\$459

In September 2011, we approved and committed to several initiatives over the following 16 months to realign our manufacturing and research and development activities in order to foster growth and enhance profitability. These initiatives are designed to align research and development activities with the location of our customers and reduce production costs. Under this plan, we reduced our global headcount, consolidated our facilities by terminating or exiting several leases, and recorded impairments for assets no longer in use due to the restructuring of our business. All activities under this restructuring plan were completed prior to December 31, 2012.



Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes our restructuring liabilities under this plan (in thousands):

	Balances at December 31, 2013	Costs incurred and charged to expense	Cost paid or otherwise settled	Effect of change in exchange rates	Balances at June 30, 2014
Severance and related costs	\$217	\$—	\$(11	) \$—	\$206
Facility closure costs	414	—	(57	) —	357
Total restructuring liabilities	\$631	\$—	\$(68	) \$—	\$563

## NOTE 14. WARRANTIES

Provisions of our sales agreements include product warranties customary to these types of agreements, ranging from 18 months to 24 months following installation for Precision Power products and 3 years to 10 years following installation for Inverter products. Our provision for the estimated cost of warranties is recorded when revenue is recognized. The warranty provision is based on historical experience by product, configuration and geographic region. We establish accruals for warranty issues that are probable to result in future costs. Changes in product warranty accruals are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balances at beginning of period	\$20,650	\$13,739	\$22,067	\$14,797
Warranty liabilities acquired	19,684	10,678	19,684	10,678
Increases to accruals related to sales during the period	1,857	3,703	3,425	5,704
Warranty expenditures	(4,601	) (7,701	) (7,586	) (10,760
Balances at end of period	\$37,590	\$20,419	\$37,590	\$20,419

## NOTE 15. PENSION LIABILITY

In connection with the HiTek acquisition discussed in Note 2. Business Acquisitions, we acquired the HiTek Power Limited Pension Scheme ("HPLPS"). The HPLPS has been closed to new participants and additional accruals since 2006. In order to measure the expense and related benefit obligation, various assumptions are made including discount rates used to value the obligation, expected return on plan assets used to fund these expenses and estimated future inflation rates. These assumptions are based on historical experience as well as facts and circumstances. An actuarial analysis is used to measure the expense and liability associated with pension benefits. The net amount of the pension liability on our balance sheet as of June 30, 2014 was \$20.4 million.

The components of the net periodic pension expense for the three and six months ended June 30, 2014 were as follows (in thousands):

	Three and Six Months Ended June 30, 2014
Net periodic benefit expense:	
Interest cost	\$(181
Expected return on plan assets	361
Net periodic benefit expense	\$180



Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

NOTE 16. STOCK-BASED  
COMPENSATION

We recognize stock-based compensation expense in Selling, general & administrative expenses based on the fair value of the awards issued. Stock-based compensation for the three and six months ended June 30, 2014 and 2013 is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Stock-based compensation expense	\$1,495	\$3,170	\$3,259	\$5,204

## Stock Options

Stock option awards, other than awards under our 2012-2014 Long Term Incentive Plan ("LTI Plan"), are generally granted with an exercise price equal to the market price of our common stock at the date of grant, a four-year vesting schedule, and a term of 10 years.

Under the LTI Plan, we made grants of performance based options and awards during the first quarter of 2014, which will vest in one year based on the Company's achievement of return on net assets targets established by our Board of Directors at the beginning of each year. These awards are granted with an exercise price equal to the market price of our common stock at the date of grant and have a term of 10 years. The fair value of each grant was estimated on the date of grant using the Black-Scholes-Merton option pricing model utilizing an expected volatility of 53.3%, a risk-free rate of 1.7%, a dividend yield of zero, and an expected term of 5.4 years. The weighted-average grant date fair value of the options is \$13.09 per share.

A summary of our time based stock option activity for the six months ended June 30, 2014 is as follows (in thousands):

	Shares
Options outstanding at beginning of period	1,573
Options granted	—
Options exercised	(493 )
Options forfeited	(53 )
Options expired	(3 )
Options outstanding at end of period	1,024

Changes in outstanding performance based stock options during the six months ended June 30, 2014 were as follows (in thousands):

	Shares
Options outstanding at beginning of period	1,239
Options granted	51
Options exercised	(159 )
Options forfeited	(230 )
Options expired	(1 )
Options outstanding at end of period	900

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## Restricted Stock Units

Restricted Stock Units ("RSU") are generally granted with a four-year vesting schedule.

A summary of our time-based unvested RSU activity for the six months ended June 30, 2014 is as follows (in thousands):

	Shares	
Balance at beginning of period	230	
RSUs granted	76	
RSUs vested	(102	)
RSUs forfeited	(20	)
Balance at end of period	184	

Changes in the unvested performance based RSUs during the six months ended June 30, 2014 were as follows (in thousands):

	Shares	
Balance at beginning of period	1,344	
RSUs granted	59	
RSUs vested	—	
RSUs settled in cash	(418	)
RSUs forfeited	(524	)
Balance at end of period	461	

During the first quarter of 2014, Performance Stock Options ("PSOs") and Performance Stock Units ("PSUs") vested in accordance with performance targets for fiscal 2013. At that time, the Board of Directors authorized the settlement of the PSUs in cash at a value equal to the fair market value of the equity instrument on the vest date. Due to the settlement, \$11.2 million was deducted from Additional paid-in capital and paid in cash in lieu of the issuance of shares. Our statement of cash flows represents this transaction as "Settlement of performance stock units." All compensation expense related to these awards was recognized during the performance period ending December 31, 2013.

## NOTE 17. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income, net of tax, consisted of the following (in thousands):

	Foreign Currency Adjustments	Unrealized Gains (Losses) on Marketable Securities	Total Accumulated Other Comprehensive Income
Balances at December 31, 2013	\$33,463	\$(6	) \$33,457
Current period other comprehensive income (loss)	(1,661	) 1	(1,660
Balances at June 30, 2014	\$31,802	\$(5	) \$31,797

## NOTE 18. COMMITMENTS AND CONTINGENCIES

We have firm purchase commitments and agreements with various suppliers to ensure the availability of components. The obligation as of June 30, 2014 is approximately \$68.6 million. Our policy with respect to all purchase commitments, is to record losses, if any, when they are probable and reasonably estimable. We continuously monitor these commitments for exposure to potential losses and will record a provision for losses when it is deemed necessary. We are involved in disputes and legal actions arising in the normal course of our business. There have been no material developments in legal proceedings in which we are involved during the three and six months ended June 30, 2014.



Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## NOTE 19. RELATED PARTY TRANSACTIONS

During the three and six months ended June 30, 2014 and 2013, we engaged in the following transactions with companies related to members of our Board of Directors, as described below (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Sales to related parties	\$ 101	\$ 584	\$ 228	\$ 615
Rent expense to related parties	472	468	907	943

## Sales - Related Parties

Members of our Board of Directors hold various executive positions and serve as directors at other companies, including companies that are our customers. During the three and six months ended June 30, 2014, we had sales to one customer as noted above and accounts receivable from one such customer that totaled \$157,184 at June 30, 2014.

During the three and six months ended June 30, 2013, we had sales to one customer as noted above and no aggregate accounts receivable from this customer at December 31, 2013.

## Rent Expense - Related Parties

We lease our executive offices, research and development, and manufacturing facilities in Fort Collins, Colorado from a limited liability partnership in which Douglas Schatz, our former Chairman of the Board and former Chief Executive Officer, holds an interest. The leases relating to these spaces expire during 2021 and obligate us to total annual payments of approximately \$1.8 million, which includes facilities rent and common area maintenance costs.

## NOTE 20. SEGMENT INFORMATION

Precision Power Products offers power conversion products for direct current, pulsed DC mid-frequency, high voltage, and radio frequency power supplies, matching networks, RF instrumentation, and Power Control Modules ("PCM") as well as thermal instrumentation products. Our power conversion systems refine, modify, and control the raw electrical power from a utility and convert it into power that may be customized and is predictable and repeatable. Our thermal instrumentation products provide temperature measurement solutions for applications in which time-temperature cycles affect material properties, productivity, and yield. These products are used in rapid thermal processing, chemical vapor deposition, and other semiconductor and solar applications requiring non-contact temperature measurement. Our network of global service support centers offer repair services, conversions, upgrades, and refurbishments to companies using our products. Precision Power Products principally serves original equipment manufacturers ("OEMs") and end customers in the semiconductor, flat panel display, solar panel, and other capital equipment and industrial markets.

Our Inverters SBU offers both a transformer-based and a transformerless advanced grid-tied PV inverter solution primarily for commercial and utility-scale system installations. Our PV inverters are designed to convert renewable solar power, drawn from large and small scale solar arrays, into high quality, reliable electrical power. Our Inverters SBU focuses on commercial and utility-scale solar projects and installations, selling primarily to distributors, engineering, procurement, and construction contractors, developers, and utility companies. Our Inverters revenue has seasonal variations. Installations of inverters are normally lowest during the first quarter as a result of typically poor weather and as a result, reduced installation scheduling by our customers.

Our chief operating decision maker, who is our Chief Executive Officer, and other management personnel regularly review our performance and make resource allocation decisions by reviewing the results of our two business segments separately. Revenue and operating profit is reviewed by our chief operating decision maker. We have also divided inventory and property and equipment based on business segment.



Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Sales with respect to our operating segments is as follows (in thousands):

	Three Months Ended		Six Months Ended June	
	June 30,		30,	
	2014	2013	2014	2013
Precision Power Products	\$81,832	\$71,702	\$164,704	\$133,479
Inverters	64,453	68,009	122,529	118,046
Total	\$146,285	\$139,711	\$287,233	\$251,525

Income (loss) before income taxes by operating segment is as follows (in thousands):

	Three Months Ended		Six Months Ended June	
	June 30,		30,	
	2014	2013	2014	2013
Precision Power Products	\$18,362	\$14,406	\$41,573	\$21,917
Inverters	(6,606 )	(1,772 )	(12,904 )	(1,564 )
Total segment operating income	11,756	12,634	28,669	20,353
Restructuring charges	(244 )	(24,206 )	(244 )	(24,206 )
Other income (expense), net	25	(330 )	(71 )	(533 )
Income (loss) before income taxes	\$11,537	\$(11,902 )	\$28,354	\$(4,386 )

Beginning in 2014, certain support functions such as human resources, information technology, accounting and finance, and legal, are now allocated to the business units based on corporate activities in each product area. This change was implemented in an effort to provide investors with a clearer understanding of the business unit's operating performance.

Segment assets consist of inventories, net and property and equipment, net. A summary of consolidated total assets by segment follows (in thousands):

	June 30, 2014	December 31, 2013
Precision Power Products	\$50,492	\$39,450
Inverters	99,428	104,227
Total segment assets	149,920	143,677
Unallocated corporate property and equipment	1,088	982
Unallocated corporate assets	553,139	508,318
Consolidated total assets	\$704,147	\$652,977

"Corporate" is a non-operating business segment with the main purpose of supporting operations. Unallocated corporate assets include accounts receivable, deferred income taxes, other current assets and intangible assets.

During the three months ended June 30, 2014, we had two customers which individually accounted for 10% or more of our sales. Sales to Applied Materials, Inc. and LAM Research were \$21.2 million and \$15.0 million or 14.5% and 10.3%, respectively, of total sales for the three month period. During the six months ended June 30, 2014, we had three customers which individually accounted for 10% or more of our sales. Sales to Applied Materials, Inc., LAM Research, and AMEC were \$48.2 million, \$32.8 million, and \$31.9 million. During the three and six months ended June 30, 2013, we had one customer individually accounting for 10% or more of our sales. Sales to Applied Materials, Inc. were \$22.9 million or 16.4% of total sales during the three month period and \$41.6 million or 16.8% for the six month period. Our sales to Applied Materials, Inc. and LAM Research include precision power products used in semiconductor processing and solar, flat panel display, and architectural glass applications. Our sales to AMEC include solar inverters. No other customer accounted for 10% or more of our sales during these periods.

Table of Contents

ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## NOTE 21. CREDIT FACILITIES

In October 2012, we, along with two of our wholly-owned subsidiaries, AE Solar Energy, Inc. and Sekidenko, Inc., entered into a Credit Agreement, subsequently amended in November 2012 and August 2013, (the "Credit Agreement") with Wells Fargo Bank, National Association ("Wells Fargo"), as agent for and on behalf of certain lenders (each a "Lender"), which provides for a new secured revolving credit facility of up to \$50.0 million (the "Credit Facility"). The Credit Facility provides us with the ability to borrow up to \$50.0 million, although the amount of the Credit Facility may be increased by an additional \$25.0 million up to a total of \$75.0 million subject to receipt of lender commitments and other conditions. Borrowings under the Credit Facility are subject to a borrowing base based upon our domestic accounts receivable and inventory and are available for various corporate purposes, including general working capital, capital expenditures, and certain permitted acquisitions. The Credit Agreement also permits us to issue letters of credit which reduce availability under the Credit Agreement. The maturity date of the Credit Facility is October 12, 2017.

At our election, the loans comprising each borrowing will bear interest at a rate per annum equal to either: (a) a "base rate" plus between one-half (0.5%) and one (1.0%) full percentage point depending on the amount available for additional draws under the Credit Facility ("Base Rate Loan"); or (b) the LIBOR rate then in effect plus between one and one-half (1.5%) and two (2%) percentage points depending on the amount available for additional draws under the Credit Facility. The "base rate" for any Base Rate Loan will be the greatest of the federal funds rate plus one-half (0.5%) percentage point; the one-month LIBOR rate plus one (1.0%) percentage point; and Wells Fargo's "prime rate" then in effect. As of June 30, 2014, the rate in effect was 3.75%.

The Credit Agreement requires us to pay certain fees to the Lenders and contains affirmative and negative covenants, which, among other things, require us to deliver to the Lenders specified quarterly and annual financial information, and limit us and our Guarantors (as defined below), subject to various exceptions and thresholds, from, among other things: (i) creating liens on our assets; (ii) merging with other companies or engaging in other extraordinary corporate transactions; (iii) selling certain assets or properties; (iv) entering into transactions with affiliates; (v) making certain types of investments; (vi) changing the nature of our business; and (vii) paying certain distributions or certain other payments to affiliates. Additionally, there are the following financial covenants: (i) during any period in which \$12.5 million or less is available to us under the Credit Facility and for sixty (60) days thereafter, the Credit Agreement requires the maintenance of a defined consolidated fixed charge coverage ratio; and (ii) if there is any indebtedness under any issued and outstanding convertible notes, we are required to maintain a specified level of liquidity.

The Credit Agreement requires us to pay certain fees to the Lenders, including a \$2,500 collateral management fee for each month that the Credit Facility is in place, and a fee based on the unused amount of the Credit Facility. During the six months ended June 30, 2014 and 2013, we expensed \$0.2 million and \$0.2 million, respectively, in interest and fees related to unused line of credit fees and amortization of debt issuance costs. We did not borrow against the Credit Facility during the six months ended June 30, 2014.

Pursuant to a Guaranty and Security Agreement (the "GS Agreement"), borrowings under the Credit Facility are guaranteed by our wholly-owned subsidiaries Aera Corporation and AEI US Subsidiary, Inc., (collectively the "Guarantors"). Under the GS Agreement, we and the Guarantors granted the Lenders a security interest in certain, but not all, of our and the Guarantors' assets.

As part of the acquisition of Refusol described in Note 2. Business Acquisitions, we assumed the outstanding debt of Refusol as of the acquisition date. There were three outstanding loans with banks related to this debt, of which one was repaid and cancelled during the third quarter of 2013.

Refusol, GmbH had an outstanding loan agreement with Commerzbank Aktiengesellschaft ("Commerzbank") for up to 8.0 million Euros ("Commerzbank Loan Agreement"). The agreement allowed Refusol to borrow up to 8.0 million Euros through various types of instruments including an overdraft (revolving) facilities, money market (term) loans, surety loans, or guarantees. There was no maturity date. Borrowings under the revolving credit facility bore interest at 5.32%. Surety and guarantee loans bore interest at 1.5%. The Commerzbank Loan Agreement required the payment of

a credit commission of 0.5% of the total loan amount. The agreement contains various covenants including a financial covenant requiring a specified level of equity. This line of credit was repaid and cancelled in the second quarter of 2014.

Refusol, GmbH also had an outstanding loan agreement with Bayerische Landesbank ("Bayern") which allowed it to borrow up to 4.0 million Euros either as overdraft facilities, term loans, or guarantees with repayment occurring one lump sum at the maturity date of the individual transaction with respect to term loans, or maturity of the loan agreement which was July 31, 2013 (the "Bayern Loan Agreement"). The overdraft facility bore interest at 4.5%. Term loans bore interest at the money market



Table Of Contents

rate established by Bayern at the time of the loan plus a margin of 1.9%. Guarantees bore interest at 1.25% and had an issuing fee per guarantee. Loan commitment fees were 0.25% on the unused portion of the total loan amount. The Bayern Loan Agreement contained certain reporting requirements and a financial covenant requiring a specified level of equity.

Upon expiration of this agreement, Refusol, GmbH entered into a new loan agreement with Bayerische Landesbank ("Bayern") under which it has the ability to borrow up to 4.0 million Euros (equal to \$5.5 million on June 30, 2014) as either bank overdrafts, term loans, guarantees, or letters of credit. The overdraft facility bears interest at 3.9%, guarantees bears a rate of 1.64% and interest on term loans is a fixed rate set for each term loan period based on money market rates. Loan commitment fees are 0.25%. The loan matures on July 31, 2014. At June 30, 2014 \$4.6 million was outstanding on this line of credit and the Company is in discussions with Bayern related to the possibility of renewing the loan agreement.

Refusol, Inc., a wholly-owned subsidiary of Refusol, GmbH located in the United States, had a revolving line of credit with Wells Fargo with an aggregate principal amount of \$1.5 million and a maturity date of July 1, 2013. Borrowings under the line of credit were secured by all of Refusol, Inc.'s accounts receivable, inventory, and property, plant, and equipment and a letter of credit issued under the Commerzbank Loan Agreement. The line of credit bore interest at either (a) a fluctuating rate per annum one quarter of one percent (0.25%) above the Prime Rate or (b) the LIBOR rate then in effect plus two percent (2.0%). Refusol, Inc. had the option to select the method of interest each month. A commitment fee of 0.125% was payable by Refusol, Inc. on the unused portion of the line of credit. The line of credit contained certain affirmative and negative covenants limiting Refusol, Inc.'s ability to borrow additional funds or guarantee the debt of others. This line of credit was paid down and cancelled on its maturity date of July 1, 2013.

**NOTE 22. SUBSEQUENT EVENT**

On August 4, 2014, Advanced Energy acquired UltraVolt, Inc., a privately-held provider of high voltage power solutions. Based in Ronkonkoma, New York, UltraVolt has a comprehensive portfolio of high voltage power supplies and modules ranging from benchtop and rack mount systems to microsize PCB-mount modules. Its standard DC-to-DC product line consists of over 1,500 models, which can be combined with accessories and options to create thousands of product configurations. Serving over 100 markets, UltraVolt's fixed-frequency, high-voltage topology provides wide input and output operating ranges while retaining excellent stability and efficiencies. We acquired UltraVolt to expand our product offerings in our Precision Power Products portfolio.

Under the agreement, Advanced Energy has acquired UltraVolt for a purchase price of \$30.2 million in cash. The preliminary base price is subject to a post-closing adjustment based on confirmation of the financial statements of UltraVolt effective as of the closing date.

Table Of Contents

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

Special Note on Forward-Looking Statements

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. Statements in this report that are not 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 continue. The inclusion of words such as "anticipate," "expect," "estimate," "can," "may," "continue," "enables," "plan," "intend," "could," or "believe," as well as statements that events or circumstances "will" occur or continue, indicate forward-looking statements. Forward-looking statements involve risks and uncertainties, which are difficult to predict and many of which are beyond our control. Therefore, actual results could differ materially and adversely from those expressed in any forward-looking statements. For additional information regarding factors that may affect our actual financial condition, results of operations and accuracy of our forward-looking statements, see the information under the caption "Risk Factors" in Part II Item 1A of this Quarterly Report on Form 10-Q and, in our Annual Report on Form 10-K for the year ended December 31, 2013. We undertake no obligation to revise or update any forward-looking statements for any reason.

BUSINESS OVERVIEW

We design, manufacture, sell and support power conversion and control products that transform power into various usable forms. Our products enable manufacturing processes that use thin film and plasma enhanced chemical and physical processing for various products, industrial thermal application for material and chemical processes, precision power for analytical instrumentation, as well as grid-tied power conversion. We also supply thermal instrumentation products for advanced temperature control in the thin film process for these markets. Our network of global service support centers provides local repair and field service capability in key regions.

Our power conversion products refine, modify and control the raw electrical power from a utility and convert it into power that is predictable, repeatable and customizable. Our power conversion products are primarily used by semiconductor, solar panel and similar thin-film manufacturers including flat panel display, data storage, hard and optical coating, and architectural glass manufacturers.

Our power control modules, through the acquisition from AEG Power Solutions, provide power control solutions for industrial applications where heat treatment and processing are used such as glass manufacturing, metal fabrication and treatment, material and chemical processing.

Our high voltage products through the acquisition of HiTek Power provide high voltage power supplies that are used in semiconductor applications such as ion implantation and scanning electron microscopy and for x-ray and mass spectroscopy applications as well as general electron gun sources for scientific and industrial applications.

Our thermal instrumentation products, used primarily in the semiconductor industry, provide temperature measurement and control solutions for applications in which time-temperature cycles affect productivity and yield. These products are used in rapid thermal processing, chemical vapor deposition, and other semiconductor and solar applications requiring non-contact temperature measurement.

Our grid-tied power conversion products offer advanced transformer-based or transformerless grid-tied PV solutions for commercial and utility-scale system installations. Our PV inverters are designed to convert renewable solar power, drawn from large and small scale solar arrays, into high quality, reliable electrical power. These products are used for commercial and utility-scale solar projects and installations, and are sold primarily to distributors; engineering, procurement, and construction contractors; developers; and utility companies. These product revenues have seasonal variations. Installations of inverters are normally lowest during the first quarter of the year due to less favorable weather conditions and resultant reduced installation scheduling by our customers.

Our network of global service support centers offer repair services, upgrades and refurbishments to businesses that use our products.

On April 8, 2013, we acquired Refusol Holdings GmbH ("Refusol"), a privately held company based in Metzingen, Germany. The financial results discussed below include the financial results of Refusol for the period from April 8, 2013 to June 30,



Table Of Contents

2013 and the three and six months ended June 30, 2014. Note 2. Business Acquisitions in Part I Item 1 of this Form 10-Q describes the acquisition of Refusol.

As also noted in Note 2. Business Acquisitions in Part I Item 1 of this Form 10-Q, we acquired the assets of Power Control Modules ("PCM") on January 27, 2014. The financial results discussed below include the financial results of PCM for the period January 27, 2014 through June 30, 2014.

Additionally, on April 12, 2014, we acquired HiTek Power Group ("HiTek"), a privately held provider of high voltage power solutions, based in the United Kingdom. The financial results discussed below include the financial results of HiTek for the period April 12, 2014 through June 30, 2014. Note 2. Business Acquisitions in Part I Item 1 of this Form 10-Q describes the acquisition of HiTek.

Our analysis presented below is organized to provide the information we believe will be helpful for understanding our historical performance and relevant trends going forward. This discussion should be read in conjunction with our Condensed Consolidated Financial Statements in Part I, Item 1 of this report, including the notes thereto. Also included in the following analysis are measures that are not in accordance with U.S. GAAP. A reconciliation of the non-GAAP measures to U.S. GAAP is provided below.

## Results of Operations

The following table sets forth, for the periods indicated, certain data derived from our Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended		Six Months Ended June	
	June 30,		30,	
	2014	2013	2014	2013
Sales	\$146,285	\$139,711	\$287,233	\$251,525
Gross profit	52,546	53,259	105,207	95,098
Operating expenses	41,034	64,831	76,782	98,951
Operating income (loss)	11,512	(11,572)	28,425	(3,853)
Other income (expenses), net	25	(330)	(71)	(533)
Income (loss) before income taxes	11,537	(11,902)	28,354	(4,386)
Provision (benefit) for income taxes	891	(2,120)	2,993	(1,430)
Income (loss) net of income taxes	\$10,646	\$(9,782)	\$25,361	\$(2,956)

The following table sets forth, for the periods indicated, the percentage of sales represented by certain items reflected in our Condensed Consolidated Statements of Operations:

	Three Months Ended June		Six Months Ended June 30,	
	30,		30,	
	2014	2013	2014	2013
Sales	100.0	% 100.0	% 100.0	% 100.0
Gross profit	35.9	38.1	36.6	37.8
Operating expenses	28.1	46.4	26.7	39.3
Operating income (loss)	7.8	(8.3)	9.9	(1.5)
Other income (expenses), net	—	(0.2)	—	(0.2)
Income (loss) before income taxes	7.9	(8.5)	9.9	(1.7)
Provision (benefit) for income taxes	0.6	(1.5)	1.0	(0.6)
Income (loss) net of income taxes	7.3	% (7.0)	% 8.9	% (1.1)

Table Of Contents

## SALES

The following tables summarize sales, and percentages of sales, by segment for the three and six months ended June 30, 2014 and 2013 (in thousands):

	Three Months Ended June 30,					Increase/ (Decrease)	Percent Change	
	2014	% of Total Sales		2013	% of Total Sales			
Precision Power Products:								
Semiconductor capital equipment	\$49,261	33.7	% \$41,067	29.4	% \$8,194	20.0	%	
Non-semiconductor capital equipment	20,911	14.3	18,494	13.2	2,417	13.1		
Global support	11,660	7.9	12,141	8.7	(481)	(4.0)	)	
Total Precision Power Products	81,832	55.9	71,702	51.3	10,130	14.1		
Inverters	64,453	44.1	68,009	48.7	(3,556)	(5.2)	)	
Total sales	\$146,285	100.0	% \$139,711	100.0	% \$6,574	4.7	%	
Six Months Ended June 30,								
	2014	% of Total Sales	2013	% of Total Sales	Increase/ (Decrease)	Percent Change		
Precision Power Products:								
Semiconductor capital equipment	\$105,576	36.7	% \$73,767	29.3	% \$31,809	43.1	%	
Non-semiconductor capital equipment	35,691	12.4	35,104	14.0	587	1.7		
Global support	23,437	8.2	24,608	9.8	(1,171)	(4.8)	)	
Total Precision Power Products	164,704	57.3	133,479	53.1	31,225	23.4		
Inverters	122,529	42.7	118,046	46.9	4,483	3.8		
Total sales	\$287,233	100.0	% \$251,525	100.0	% \$35,708	14.2	%	
Total Sales								

Overall, our sales increased \$6.6 million, or 4.7%, to \$146.3 million for the three months ended June 30, 2014 from \$139.7 million for the three months ended June 30, 2013. The increase in the quarter was primarily due to the acquisitions of the PCM and HiTek product lines.

For the six months ended June 30, 2014, sales increased \$35.7 million, or 14.2%, to \$287.2 million from \$251.5 million for the six months ended June 30, 2013. The majority of the increase was attributable to the continuation of the capital investment in the semiconductor market driven by advanced memory (V-NAND) and 20nm capacity build-outs in Asia, as well as the additions of the three-phase string inverter, PCM and HiTek product lines. These increases were partially offset by a decline in sales in the flat panel display markets.

## Precision Power Products

Results for Precision Power Products for the three and six months ended June 30, 2014 and 2013 were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Sales	\$81,832	\$71,702	\$164,704	\$133,479
Operating income	18,362	14,406	41,573	21,917

Precision Power Products sales increased 14.1% to \$81.8 million, or 55.9% of sales, for the three months ended June 30, 2014 versus \$71.7 million, or 51.3% of sales, for the three months ended June 30, 2013. While semiconductor sales slowed slightly in the second quarter as expected, this was offset by the addition of the HiTek power line as well as an increase in industrial sales, driven by the addition of the HiTek and PCM product lines. In the three months ended June 30, 2014, sales in the Precision Power Products semiconductor market increased 20.0% to \$49.3 million, or 33.7% of sales, from \$41.1 million, or 29.4% of sales for the three months ended June 30, 2013. Market



Table Of Contents

conditions remained strong across the semiconductor market as we continued to benefit from the completion of the investment cycle in Memory and leading 20nm capacity ramping by fab customers in Asia. We expect a slight pause in semiconductor investments as fab customers digest the last two quarters of heavy investment. The memory sector investment for the second half of the year remains unclear as some fab customers appear to be delaying the next phase of expansion. The potential delay is being driven by initial yield concerns and the current oversupply in the NAND memory market.

Sales in the non-semiconductor capital equipment markets increased 13.1% to \$20.9 million, or 14.3% of sales, for the three months ended June 30, 2014 compared to \$18.5 million, or 13.2% of sales, for the three months ended June 30, 2013. The markets that comprise the Precision Power Products non-semiconductor capital equipment markets include solar panel, flat panel display, power control modules, data storage, architectural glass and other industrial manufacturing equipment markets. Our customers in these markets are primarily global OEMs. Our hard-coating and high voltage power product lines were key focus areas for the quarter and we saw the automotive market continue strong growth in the US and Asia.

Our global support revenue decreased to \$11.7 million, or 7.9% of total sales, for the three months ended June 30, 2014, compared to \$12.1 million, or 8.7% of sales, for the three months ended June 30, 2013. Lower utilization rates on coating products in Europe have resulted in a decline in repair returns.

Operating income for Precision Power Products was \$18.4 million for the three months ended June 30, 2014, an increase of \$4.0 million from the same period of 2013. High sales volumes continued to drive improved manufacturing efficiencies and resulted in the increase in operating income.

**Inverters**

Results for our Inverters SBU for the three and six months ended June 30, 2014 and 2013 are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Sales	\$64,453	\$68,009	\$122,529	\$118,046
Operating loss	(6,606	) (1,772	) (12,904	) (1,564

Inverters sales were \$64.5 million, or 44.1% of sales, for the three months ended June 30, 2014 as compared to \$68.0 million, or 48.7% of sales, for the three months ended June 30, 2013. Challenging market conditions continued into the second quarter of 2014 with the US commercial market experiencing a shift away from central inverters. In addition, the unfavorable decision expanding tariffs on the import of solar cells and panels manufactured in China to cells manufactured in Taiwan and elsewhere resulted in project delays. Germany and Southern and Eastern European markets were impacted by project financing challenges and the uncertainty of a pending proposal to tax self-consumption of green energy. This has resulted in softness in those markets as small to mid-size customers weigh their willingness to invest in solar energy. Public policy considerations continue to disrupt the solar energy market. The decline in central inverters has been stabilized by strong momentum in the US three-phase string product line markets. We will continue our global ramp up of the three-phase string product line as we believe the momentum of the three-phase string products will accelerate, while a steady decline in the central inverters is projected into future quarters.

Operating loss for Inverters was \$6.6 million for the three months ended June 30, 2014 as compared to operating loss of \$1.8 million for the three months ended June 30, 2013. Lower sales volume, higher costs associated with the 3TL product line ramp up and shift in product line sales mix contributed to the increased operating loss.

**Backlog**

Our overall backlog was \$93.6 million at June 30, 2014 as compared to \$128.3 million at December 31, 2013. The decrease is primarily the result of a decrease in Inverters backlog.

**GROSS PROFIT**

Our gross profit was \$52.5 million, or 35.9% of sales, for the three months ended June 30, 2014, as compared to \$53.3 million, or 38.1% of sales for the three months ended June 30, 2013. The year-over-year decrease in absolute dollars was a result of a shift in product mix to lower margin products as well as the addition of the HiTek product line.





Table Of Contents

## OPERATING EXPENSE

The following table summarizes our operating expenses as a percentage of sales for the three and six months ended June 30, 2014 and 2013 (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
Research and development	\$ 15,736	10.8 %	\$ 15,740	11.3 %	\$ 29,878	10.4 %	\$ 29,993	11.9 %
Selling, general, and administrative	22,828	15.6	22,910	16.4	42,559	14.8 %	40,564	16.1
Amortization of intangible assets	2,226	1.5	1,975	1.4	4,101	1.4 %	4,188	1.7
Restructuring charges and asset impairment	244	0.2	\$ 24,206	17.3	244	0.1 %	24,206	9.6
Total operating expenses	\$ 41,034	28.1 %	\$ 64,831	46.4 %	\$ 76,782	26.7 %	\$ 98,951	39.3 %

## Research and Development

The markets we serve constantly present opportunities to develop products for new or emerging applications and require technological changes driving for higher performance, lower cost, and other attributes that we expect may advance our customers' products. We believe that continued and timely development of new and differentiated products, as well as enhancements to existing products to support customer requirements, are critical for us to compete in the markets we serve. Accordingly, we devote significant personnel and financial resources to the development of new products and the enhancement of existing products, and we expect these investments to continue.

Research and development expenses for the three months ended June 30, 2014 were \$15.7 million, or 10.8% of sales, as compared to \$15.7 million, or 11.3% of sales, for the three months ended June 30, 2013. Research and development costs remained relatively flat in the three and six months ended June 30, 2014 as compared to the same periods in 2013 as a result of our focus on reducing costs.

## Selling, General and Administrative

Our selling expenses support domestic and international sales and marketing activities that include personnel, trade shows, advertising, third-party sales representative commissions, and other selling and marketing activities. Our general and administrative expenses support our worldwide corporate, legal, tax, financial, governance, administrative, information systems, and human resource functions in addition to our general management, including acquisition-related activities.

Selling, general and administrative ("SG&A") expenses remained relatively flat in the three months ended June 30, 2014 as compared to the same period in 2013. SG&A costs increased significantly in the six months ended June 30, 2014 as compared to the same period in 2013 due to the acquisitions of both the HiTek and PCM product lines.

## Amortization Expense

Amortization of intangible assets expense was \$2.2 million for the three months ended June 30, 2014, compared to \$2.0 million for the same period ending June 30, 2013. During the second and third quarters of 2013, we recorded an impairment of intangible assets related to our acquisition of PV Powered in May 2010. Our initial estimate of the impairment was recorded in the second quarter with the final value determined during the third quarter. As a result of the acquisition of the three-phase string inverter product line, we assessed the overall Inverter product line for product optimization, resulting in an impairment to the technology purchased from PV Powered. This reduced amortization expense related to these products which was offset by increases in amortization expense related to the intangible assets acquired in the Refusol, PCM, and HiTek acquisitions.

## Restructuring Charges

In April 2014, we committed to a restructuring plan to take advantage of additional cost savings opportunities in connection with our acquisitions and realignment to a single organizational structure based on product line. The plan calls for consolidating certain facilities and rebranding of products which will allow us to use our resources more efficiently. Over the next six months, we plan to incur additional charges of approximately \$2.0 million.



Table Of Contents

## Other Income (Expenses), net

Other income (expenses), net consists primarily of interest income and expense, foreign exchange gains and losses, gains and losses on sales of fixed assets, and other miscellaneous items. Other income (expenses), net was negligible for the three and six months ended June 30, 2014 as compared to \$0.3 million and \$0.5 million losses in the same periods of 2013. The change is primarily due to the flux in foreign exchange rates.

## Provision (Benefit) for Income Taxes

We recorded an income tax provision from continuing operations for the three months ended June 30, 2014 of \$0.9 million compared to benefit of \$2.1 million for the three months ended June 30, 2013, resulting in effective tax rates of 7.7% and 17.8%, respectively. Our tax rate is lower than the federal statutory rate primarily due to the benefit of earnings in foreign jurisdictions which are subject to lower tax rates. The effective tax rate for the period does not reflect the benefit for the US research and development tax credit which expired December 31, 2013. For the three and six months ended June 30, 2013, the effective tax rate reflected benefits attributable to the restructuring expenses and the January 2, 2013 reinstatement of the 2012 US research and development tax credit.

Our future effective income tax rate depends on various factors, such as changes in tax laws, regulations, accounting principles, or interpretations thereof and the geographic composition of our pre-tax income. We carefully monitor these factors and adjust our effective income tax rate accordingly.

## Non-GAAP Results

To evaluate business performance against business objectives and for planning purposes, management uses non-GAAP results. We believe these measures will enhance investors' ability to review our business from the same perspective as management and facilitate comparisons of this period's results with prior periods. These non-GAAP measures are not in accordance with U.S. GAAP and may differ from non-GAAP methods of accounting and reporting used by other companies. The presentation of this additional information should not be considered a substitute for results prepared in accordance with U.S. GAAP.

The non-GAAP results presented below exclude the impact of stock-based compensation, amortization of intangible assets, and acquisition-related costs (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Income, net of tax, as reported	\$10,646	\$(9,782)	\$25,361	\$(2,956)
Adjustments, net of tax:				
Restructuring charges	225	19,579	225	19,579
Acquisition-related costs	434	—	662	993
Stock-based compensation	1,380	2,524	2,924	4,371
Amortization of intangible assets	2,052	1,573	3,694	3,583
Nonrecurring executive severance	800	—	800	—
Non-GAAP income, net of tax	\$15,537	\$13,894	\$33,666	\$25,570
Diluted weighted-average common shares outstanding	41,147	40,150	41,419	39,899
Non-GAAP Earnings Per Share	\$0.38	\$0.35	\$0.81	\$0.64

## Impact of Inflation

In recent years, inflation has not had a significant impact on our operations. However, we continuously monitor operating price increases, particularly in connection with the supply of component parts used in our manufacturing process. To the extent permitted by competition, we pass increased costs on to our customers by increasing sales prices over time. From time to time, we may also receive pressure from customers to decrease sales prices due to reductions in the cost structure of our products from cost improvement initiatives and decreases in component part prices.

Table Of Contents

## Liquidity and Capital Resources

## LIQUIDITY

We believe that adequate liquidity and cash generation is important to the execution of our strategic initiatives. Our ability to fund our operations, acquisitions, capital expenditures, and product development efforts may depend on our ability to generate cash from operating activities which is subject to future operating performance, as well as general economic, financial, competitive, legislative, regulatory, and other conditions, some of which may be beyond our control. Our primary sources of liquidity are our available cash, investments, and cash generated from current operations as well as our credit facilities discussed in Note 20. Credit Facilities in Part I Item 1 of this Form 10-Q. At June 30, 2014, we had \$130.2 million in cash, cash equivalents, and marketable securities. We believe that our current cash levels and our cash flows from future operations will be adequate to meet anticipated working capital needs, anticipated levels of capital expenditures, and contractual obligations for the next twelve months. We may seek additional financing from time to time.

On October 12, 2012, we entered into an agreement with Wells Fargo Bank, National Association which provides for a secured revolving credit facility ("Credit Facility") of up to \$50.0 million. As of June 30, 2014, we had \$50.0 million of availability on our Wells Fargo Credit Facility. Borrowings under the Credit Facility are subject to a borrowing base based upon our accounts receivable and inventory and are available for various corporate purposes. The Credit Facility provides us further flexibility for execution of our strategic plans including acquisitions. Refusol initially had two outstanding notes with various banks that provided up to 12.0 million Euros of borrowing, which we assumed in the acquisition. During the quarter ended June 30, 2014 one of these revolving lines was repaid and cancelled. As of June 30, 2014 there was \$4.6 million outstanding on the remaining note. For more information on these Credit Facilities see Note 20. Credit Facilities of our Consolidated Financial Statements.

## CASH FLOWS

A summary of our cash provided by and used in operating, investing and financing activities is as follows (in thousands):

	Six Months Ended June 30,	
	2014	2013
Net cash provided by (used in) operating activities	\$47,073	\$(10,012)
Net cash used in investing activities	(31,478)	(67,479)
Net cash provided by (used in) financing activities	(35,509)	17,762
EFFECT OF CURRENCY TRANSLATION ON CASH	(662)	227
DECREASE IN CASH AND CASH EQUIVALENTS	(20,576)	(59,502)
CASH AND CASH EQUIVALENTS, beginning of period	138,125	146,564
CASH AND CASH EQUIVALENTS, end of period	\$ 117,549	\$ 87,062

## 2014 CASH FLOWS COMPARED TO 2013

## Net cash provided by (used in) operating activities

Net cash provided by operating activities for the six months ended June 30, 2014 was \$47.1 million, compared to net cash used in operating activities of \$10.0 million for the same period ended June 30, 2013. The increase of \$57.1 million in net cash flows from operating activities is primarily the result of higher net income and lower income taxes paid during the quarter.

## Net cash used in investing activities

Net cash used in investing activities for the six months ended June 30, 2014 was \$31.5 million, a decrease of \$36.0 million from the same period ended June 30, 2013. The decrease in cash used is due to the cash payment of \$77.2 million for the acquisition of the Refusol in 2013, compared to the \$30.3 million cash payment for the acquisition of PCM in 2014. Capital expenditures for the six months ended June 30, 2014 were \$0.4 million lower compared to the same period in 2013.

## Net cash provided by (used in) financing activities

Net cash used by financing activities in the six months ended June 30, 2014 was \$35.5 million, a \$53.3 million change from the cash provided by financing activities of \$17.8 million in the same period of 2013. This was primarily due to the settlement



Table Of Contents

of performance stock units in cash of \$11.2 million in the first quarter of 2014, coupled with the completion of the \$25 million stock buyback program. Additionally, the exercise of stock options provided \$8.9 million of cash in 2014 as compared to \$16.9 million in 2013. Furthermore, the paydown of the Commerzbank note utilized \$11.6 million in cash in 2014.

Effect of currency translation on cash

During the six months ended June 30, 2014, currency translation had a negative \$0.7 million impact on cash compared to a positive impact of \$0.2 million in the same period of 2013. Our foreign operations primarily sell product and incur expenses in the related local currency. Exchange rate fluctuations could require us to increase prices to foreign customers, which could result in lower net sales by us to such customers. Alternatively, if we do not adjust the prices for our products in response to unfavorable currency fluctuations, our results of operations could be materially and adversely impacted. Given recent acquisitions in Europe, our exposure to fluctuations in the value of the Euro and Pound Sterling is becoming more significant. The functional currencies of our worldwide operations include U.S. dollar ("USD"), Canadian Dollar ("CAD"), Swiss Franc ("CHF"), Chinese Yuan ("CNY"), Euro ("EUR"), Pound Sterling ("GBP"), Indian Rupee ("INR"), Japanese Yen ("JPY"), South Korean Won ("KRW"), and New Taiwan Dollar ("TWD"). Our purchasing and sales activities are primarily denominated in USD, CNY, EUR, and JPY. The change in these key currency rates during the six months ended June 30, 2014 and 2013 are as follows:

From	To	Six Months Ended June 30,			
		2014	2013		
CAD	USD	(0.4	)% (5.7	)%	
CHF	USD	0.7	(3.1	)	
CNY	USD	(2.4	)	1.1	
EUR	USD	(0.4	)	(1.4	)
GBP	USD	3.3	(6.4	)	
INR	USD	3.0	(7.7	)	
JPY	USD	3.9	(12.5	)	
KRW	USD	4.3	(6.9	)	
TWD	USD	0.1	(3.6	)	

Off Balance Sheet Arrangements

We have no off-balance sheet arrangements or variable interest entities.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires us to make judgments, assumptions and estimates that affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013 describes the significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. Our critical accounting estimates, discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2013, include estimates for allowances for doubtful accounts, determining useful lives for depreciation and amortization, the valuation of assets and liabilities acquired in business combinations, assessing the need for impairment charges for identifiable intangible assets and goodwill, establishing warranty reserves, accounting for income taxes, and assessing excess and obsolete inventories. Such accounting policies and estimates require significant judgments and assumptions to be used in the preparation of the Condensed Consolidated Financial Statements and actual results could differ materially from the amounts reported based on variability in factors affecting these estimates.

Our management discusses the development and selection of our critical accounting policies and estimates with the Audit Committee of our Board of Directors at least annually. Our management also internally discusses the adoption of new accounting policies or changes to existing policies at interim dates, as it deems necessary or appropriate.



Table Of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our market risk exposure relates to changes in interest rates in our investment portfolio and credit facility. 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 June 30, 2014, our investments consisted primarily of certificates of deposit and institutional money markets, all with maturity of less than 2 years. As a measurement of the sensitivity of our portfolio and assuming that our investment portfolio balances remain constant, a hypothetical decrease of 100 basis points (1%) in interest rates would decrease annual pre-tax earnings by approximately \$0.1 million.

We had \$4.6 million of debt outstanding as of June 30, 2014 under one debt instrument with variable interest rates and principal payments. Assuming a full drawdown on all of our outstanding loan agreements subject to variable interest rates, and holding other variables constant, a hypothetical immediate one percentage point change in interest rates would be expected to have an annualized impact on pre-tax earnings and cash flows of approximately \$0.5 million.

Foreign Currency Exchange Rate Risk

We are impacted by changes in foreign currency exchange rates through sales and purchasing transactions when we sell products and purchase materials in currencies different from the currency in which product and manufacturing costs were incurred. Our purchasing and sales activities are primarily denominated in the USD, JPY, CNY and EUR. As these currencies fluctuate against each other, and other currencies, we are exposed to foreign currency exchange rate risk on sales, purchasing transactions and labor.

Our reported financial results of operations, including the reported value of our assets and liabilities, are also impacted by changes in foreign currency exchange rates. Assets and liabilities of many of our subsidiaries outside the U.S. are translated at period end rates of exchange for each reporting period. Operating results and cash flow statements are translated at weighted-average rates of exchange during each reporting period. Although these translation changes have no immediate cash impact, the translation changes may impact future borrowing capacity, and overall value of our net assets.

From time to time, we enter into foreign currency exchange rate contracts to hedge against changes in foreign currency exchange rates on assets and liabilities expected to be settled at a future date. Market risk arises from the potential adverse effects on the value of derivative instruments that result from a change in foreign currency exchange rates. We attempt to mitigate our market risk applicable to foreign currency exchange rate contracts by establishing and monitoring parameters that limit the types and degree of our derivative contract instruments. We enter into derivative contract instruments for risk management purposes only. We do not enter into or issue derivatives for trading or speculative purposes.

Currency exchange rates vary daily and often one currency strengthens against the USD while another currency weakens. Because of the complex interrelationship of the worldwide supply chains and distribution channels, it is difficult to quantify the impact of a change in one or more particular exchange rates.

See the "Risk Factors" set forth in Part I, Item 1A of our Annual Report on Form 10-K for more information about the market risks to which we are exposed. There have been no material changes in our exposure to market risk from December 31, 2013.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures, which are designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934 ("Act") is recorded, processed, summarized, and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Act is accumulated and communicated to management, including our Principal Executive Officer (Garry Rogerson, Chief Executive Officer) and Principal Financial Officer (Danny C. Herron, Executive Vice President & Chief Financial Officer), as appropriate, to allow timely decisions regarding required disclosures.





Table Of Contents

As of the end of the period covered by this report, we conducted an evaluation, with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to the Exchange Act Rule 13a-15(b). Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2014. The conclusions of the Chief Executive Officer and Chief Financial Officer from this evaluation were communicated to the Audit Committee. We intend to continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting, except as discussed below, that occurred during the fiscal quarter covered by this Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our policy is to implement effective internal controls for all acquisitions within one year of the acquisition date consistent with the rest of the organization. Refusol was acquired in April 2013. During the second quarter and third quarter prior to the filing of Form 10-Q for the period ended June 30, 2014, the Company completed its efforts to ensure the existence of controls primarily related to cash disbursements, segregation of duties, computer access controls, and computer change controls.

Table Of Contents

## PART II OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

We are involved in disputes and legal actions arising in the normal course of our business.

There have been no material developments in legal proceedings in which we are involved during the quarter ended June 30, 2014. For a description of previously reported legal proceedings refer to Part I, Item 3, "Legal Proceedings" of our Annual Report on Form 10-K for the year ended December 31, 2013.

## ITEM 1A. RISK FACTORS

Item 1A, "Risk Factors," of our Annual Report on Form 10-K for the year ended December 31, 2013 describes some of the risks and uncertainties associated with our business. The risk factors set forth below update such disclosures. Other factors may also exist that we cannot anticipate or that we currently do not consider to be significant based on information that is currently available. These risks and uncertainties have the potential to materially affect our business, financial condition, results of operations, cash flows and future results. Such risks and uncertainties also may impact the accuracy of forward-looking statements included in this Form 10-Q and other reports we file with the Securities and Exchange Commission.

Recent unfair trade complaints filed against imports of solar cells from China and Taiwan will have significant negative effects on our business, financial condition or results of operations.

In October 2011, a coalition of several U.S. solar companies filed complaints with the U.S. Department of Commerce ("DOC") and International Trade Commission ("ITC") charging that Chinese solar cell manufacturers have engaged in, and benefited from, various unfair trade practices. A similar trade case may also be filed in Europe. In early 2012, duties were imposed on solar panels imported from China which have resulted in other trade-related conflicts. Since some of our inverters are well-suited for use with crystalline silicon panel modules, the impact of these duties on the cost of solar panels would have a material adverse impact on our business, financial position or results of operations. In June 2014, the DOC imposed additional anti-dumping duties that now include Taiwanese solar cell manufacturing for Chinese solar module manufacturers. As a result of this action, the pricing of solar panels has increased for our customers in a manner that adversely affects solar project financial viability. As a result of this U.S. government action, solar projects are being delayed and could be cancelled. The imposition of these additional and expanded duties will have a material adverse impact on our business, financial position and results of operations.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

## Share Repurchases

In May 2014, our Board of Directors authorized a program to repurchase up to \$25.0 million of our stock over a twelve-month period. Under this program, during the three and six months ended June 30, 2014, we repurchased and retired approximately 1.4 million shares of our common stock for a total of \$25.0 million. Share repurchases during the three months ended June 30, 2014 are as follows (in thousands except for average price per share):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Program
May 1, 2014 to May 31, 2014	1,376	\$18.17	1,376	—
June 1, 2014 to June 30, 2014	—	\$—	—	—
Total	1,376	\$18.17	1,376	

As of June 30, 2014 we have completed the share repurchase program.



Table Of Contents

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

35

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Table Of Contents

ITEM 6. EXHIBITS

- 31.1 Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Attached as Exhibit 101 to this report are the following materials from Advanced Energy, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Statements of Earnings, (ii) the Condensed Consolidated Statements of Comprehensive Earnings, (iii) the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, (v) the Condensed Consolidated Statements of Stockholders' Equity, and (vi) the Notes to the Condensed Consolidated Financial Statements.

Table Of Contents

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.

Dated: August 7, 2014

/s/ Danny C. Herron  
Danny C. Herron  
Executive Vice President and Chief Financial  
Officer

Table Of Contents

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38