

ADVANCED ENERGY INDUSTRIES INC

Form 10-Q

July 31, 2017

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>	Emerging growth company <input type="checkbox"/>
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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 24, 2017 there were 39,942,723 shares of the registrant's Common Stock, par value \$0.001 per share, outstanding.

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PART I FINANCIAL STATEMENTS

ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ADVANCED ENERGY INDUSTRIES, INC.

Unaudited Condensed Consolidated Balance Sheets

(In thousands, except per share amounts)

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$358,937	\$281,953
Restricted cash, related to acquisition	17,732	—
Marketable securities	4,096	4,737
Accounts receivable, net of allowances of \$1,955 and \$1,943, respectively	60,791	75,667
Inventories	75,557	55,770
Income taxes receivable	2,047	1,482
Other current assets	9,930	9,324
Current assets of discontinued operations	8,058	9,401
Total current assets	537,148	438,334
Deposits and other assets	2,046	1,835
Property and equipment, net	14,537	13,337
Goodwill	44,006	42,125
Intangible assets, net	27,399	28,071
Deferred income tax assets	32,328	32,197
Non-current assets of discontinued operations	15,631	15,630
TOTAL ASSETS	\$673,095	\$571,529
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$49,430	\$46,255
Income taxes payable	4,369	1,778
Accrued payroll and employee benefits	13,977	13,230
Customer deposits	5,916	5,774
Other accrued expenses	21,553	14,590
Current liabilities of discontinued operations	9,185	13,419
Total current liabilities	104,430	95,046
Deferred income tax liabilities	1,076	1,008
Uncertain tax positions	4,287	2,538
Long term deferred revenue	37,743	39,170
Other long-term liabilities	21,931	20,536
Non-current liabilities of discontinued operations	18,240	21,157
Total liabilities	187,707	179,455
Stockholders' equity:		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none issued and outstanding	—	—
Common stock, \$0.001 par value, 70,000 shares authorized; 39,943 and 39,712 issued and outstanding, respectively	40	40
Additional paid-in capital	208,979	203,603
Retained earnings	278,951	195,364
Accumulated other comprehensive loss	(2,582)	(6,933)
Total stockholders' equity	485,388	392,074

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$673,095 \$571,529

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

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Sales:				
Product	\$143,288	\$100,752	\$272,115	\$187,045
Services	22,584	18,013	43,108	34,764
Total sales	165,872	118,765	315,223	221,809
Cost of sales:				
Product	66,491	47,334	126,608	88,149
Services	12,240	9,385	22,643	18,154
Total cost of sales	78,731	56,719	149,251	106,303
Gross profit	87,141	62,046	165,972	115,506
Operating expenses:				
Research and development	14,610	11,266	27,113	22,031
Selling, general and administrative	23,790	19,377	45,888	37,393
Amortization of intangible assets	974	1,074	1,936	2,132
Total operating expenses	39,374	31,717	74,937	61,556
Operating income	47,767	30,329	91,035	53,950
Other (expense) income, net	(83) 836	(3,291) 1,193
Income from continuing operations	47,684	31,165	87,744	55,143
Provision for income taxes	1,811	3,911	6,430	7,669
Income from continuing operations, net of income taxes	45,873	27,254	81,314	47,474
Income from discontinued operations, net of income taxes	179	3,277	2,273	5,338
Net income	\$46,052	\$30,531	\$83,587	\$52,812
Basic weighted-average common shares outstanding	39,849	39,672	39,793	39,750
Diluted weighted-average common shares outstanding	40,250	39,969	40,212	40,046
Earnings per share:				
Continuing operations:				
Basic earnings per share	\$1.15	\$0.69	\$2.04	\$1.19
Diluted earnings per share	\$1.14	\$0.68	\$2.02	\$1.19
Discontinued operations:				
Basic earnings per share	\$—	\$0.08	\$0.06	\$0.13
Diluted earnings per share	\$—	\$0.08	\$0.06	\$0.13
Net income:				
Basic earnings per share	\$1.16	\$0.77	\$2.10	\$1.33
Diluted earnings per share	\$1.14	\$0.76	\$2.08	\$1.32

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

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ADVANCED ENERGY INDUSTRIES, INC.

Unaudited Condensed Consolidated Statements of Comprehensive Income

(In thousands)

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2017	2016	2017	2016
Net income	\$46,052	\$30,531	\$83,587	\$52,812
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	1,498	(314)	4,526	263
Unrealized (loss) gain on marketable securities	(21)	1	(21)	10
Minimum benefit retirement liability	(138)	(36)	(154)	(24)
Comprehensive income	\$47,391	\$30,182	\$87,938	\$53,061

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

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

	Six Months Ended June 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$83,587	\$52,812
Income from discontinued operations, net of income taxes	2,273	5,338
Income from continuing operations, net of income taxes	81,314	47,474
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,219	4,045
Stock-based compensation expense	7,254	2,998
Loss on foreign exchange hedge	3,489	—
Net loss on disposal of assets	65	213
Changes in operating assets and liabilities, net of assets acquired:		
Accounts receivable	16,045	(10,743)
Inventories	(18,593)	(6,632)
Other current assets	(2,013)	(266)
Accounts payable	4,596	9,616
Other current liabilities and accrued expenses	8,183	(172)
Income taxes	2,054	1,551
Net cash provided by operating activities from continuing operations	106,613	48,084
Net cash used in operating activities from discontinued operations	(6,396)	(4,563)
Net cash provided by operating activities	100,217	43,521
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of marketable securities	(19)	(745)
Proceeds from sale of marketable securities	723	6,921
Restricted cash, related to acquisition	(17,732)	—
Purchase of foreign exchange hedge	(3,489)	—
Purchases of property and equipment	(3,408)	(2,865)
Net cash (used in) provided by investing activities from continuing operations	(23,925)	3,311
Net cash used in investing activities from discontinued operations	—	—
Net cash (used in) provided by investing activities	(23,925)	3,311
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (payments) proceeds related to stock-based award activities	(1,877)	1,621
Other financing activities	3	(2)
Net cash (used in) provided by financing activities from continuing operations	(1,874)	1,619
Net cash used in financing activities from discontinued operations	—	(24)
Net cash (used in) provided by financing activities	(1,874)	1,595
EFFECT OF CURRENCY TRANSLATION ON CASH	1,216	(729)
INCREASE IN CASH AND CASH EQUIVALENTS	75,634	47,698
CASH AND CASH EQUIVALENTS, beginning of period	289,517	169,720
CASH AND CASH EQUIVALENTS, end of period	365,151	217,418
Less cash and cash equivalents from discontinued operations	6,214	8,145
CASH AND CASH EQUIVALENTS FROM CONTINUING OPERATIONS, end of period	\$358,937	\$209,273
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		

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Cash paid for interest	\$—	\$105
Cash paid for income taxes	3,131	3,818
Cash received for refunds of income taxes	856	315
Cash held in banks outside the United States	228,586	140,556

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

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ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)

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 products that transform electrical power into various usable forms. Our products enable manufacturing processes that use thin films for various products, such as semiconductor devices, flat panel displays, solar cells, architectural glass, optical coating and decorative and functional coating for consumer products. 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, and material and chemical processing. Our high voltage power supplies and modules are used in applications such as semiconductor ion implantation, scanning electron microscopy, chemical analysis such as mass spectrometry and various applications using X-ray technology and electron guns for both analytical and processing applications. Our network of global service support centers provides a recurring revenue opportunity as we offer repair services, conversions, upgrades, and refurbishments and sales of used equipment to companies using our products. As of December 31, 2015, we discontinued the production, engineering, and sales of our solar inverter product line. As such, all solar inverter revenues, costs, assets and liabilities are reported in Discontinued Operations for all periods presented herein. See Note 2. Discontinued Operations.

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 as of June 30, 2017, the results of our operations for the three and six months ended June 30, 2017 and 2016, and cash flows for the six months ended June 30, 2017 and 2016.

The Unaudited 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, 2016 and other financial information filed with the SEC.

ESTIMATES AND ASSUMPTIONS

The preparation of our Unaudited 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.

CRITICAL ACCOUNTING POLICIES

Our accounting policies are described in our audited Consolidated Financial Statements and Notes contained in our Annual Report on Form 10-K for the year ended December 31, 2016.

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 Consolidated Financial Statements upon adoption.

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ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(in thousands except per share data)

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" and has subsequently issued several supplemental and/or clarifying ASUs (collectively known as "ASC 606"). ASC 606 implements a five step model for 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 for fiscal periods beginning after December 15, 2017 and for the interim periods within that year.

Advanced Energy has established a cross-functional implementation team to analyze its current portfolio of customer contracts. We have completed the disaggregation of the related sales order data and have begun testing contract elements and considering supporting software applications. The implementation team is also responsible for identifying and implementing changes to existing business processes, controls, and systems in order to support revenue recognition and disclosure under the new standard. Based on our preliminary review of our customer contracts, we expect that revenue with the majority of our customers will continue to be recognized at a point in time, generally upon shipment of products, consistent with our current revenue recognition model. Upon adoption of ASC 606, however, we also believe some of our revenue from sales of products and services to customers will be recognized over time, rather than at a point in time, due to the terms of certain customer contracts. As such, various balance sheet line items will be impacted. Advanced Energy believes the adoption of ASC606 will have an impact on both the timing of revenue recognition and various line items within the Consolidated Balance Sheet.

The standard permits the use of either the retrospective or cumulative effect transition method. Our team is continuing to evaluate 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.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within the year of adoption. Early adoption is permitted. Advanced Energy is currently assessing and has not yet determined the impact ASU 2016-02 may have on its Consolidated Financial Statements.

NOTE 2. DISCONTINUED OPERATIONS

In December 2015, we completed the wind down of engineering, manufacturing and sales of our solar inverter product line (the "inverter business"). Accordingly, the results of our inverter business has been reflected as "Income from discontinued operations, net of income taxes" on our Unaudited Condensed Consolidated Statements of Operations for all periods presented herein.

The effect of extended inverter warranty sales to our customers continues to be reflected in deferred revenue in our Unaudited Condensed Consolidated Balance Sheets. Deferred revenue for extended inverter warranties and the associated costs of warranty service will be reflected in Sales and Cost of goods sold, respectively, from continuing operations in future periods in our Consolidated Statement of Operations, as the deferred revenue is earned and the associated services are rendered. Extended warranties related to the inverter product line are no longer offered.

The items included in "Income from discontinued operations, net of income taxes" are as follows:

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2017	2016	2017	2016
Sales	\$—	\$—	\$—	\$—
Cost of sales	(69)	(1,716)	(897)	(2,423)
Total operating income (including restructuring)	(26)	(859)	(1,146)	(2,286)
Operating income from discontinued operations	95	2,575	2,043	4,709
Other income (loss)	214	(30)	377	339

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Income from discontinued operations before income taxes	309	2,545	2,420	5,048
Provision (benefit) for income taxes	130	(732)	147	(290)
Income from discontinued operations, net of income taxes	\$179	\$3,277	\$2,273	\$5,338

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ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(in thousands except per share data)

Assets and Liabilities of discontinued operations within the Condensed Consolidated Balance Sheets are comprised of the following:

	June 30, 2017	December 31, 2016
Cash and cash equivalents	\$6,214	\$ 7,564
Accounts and other receivables, net	1,339	1,670
Inventories	505	167
Current assets of discontinued operations	\$8,058	\$ 9,401
Other assets	\$71	\$ 70
Deferred income tax assets	15,560	15,560
Non-current assets of discontinued operations	\$15,631	\$ 15,630
Accounts payable and other accrued expenses	\$1,186	\$ 3,684
Accrued warranty	7,785	9,254
Accrued restructuring	214	481
Current liabilities of discontinued operations	\$9,185	\$ 13,419
Accrued warranty	\$18,016	\$ 20,976
Other liabilities	224	181
Non-current liabilities of discontinued operations	\$18,240	\$ 21,157

NOTE 3. INCOME TAXES

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Income from continuing operations before income taxes	\$47,684	\$31,165	\$87,744	\$55,143
Provision for income taxes	1,811	3,911	6,430	7,669
Effective tax rate	3.8	% 12.5	% 7.3	% 13.9

The effective tax rates for the three and six months ended June 30, 2017 differs from the federal statutory rate of 35% primarily due to the benefit of the earnings in foreign jurisdictions which are subject to lower tax rates. Additionally, in accordance with the adoption of ASU 2016-09 "Improvements to Employee Share-Based Payment Accounting" in December 2016, the excess tax benefit attributable to stock based compensation of \$3.8 million and \$4.2 million, for the three and six months ended June 30, 2017, respectively, was recognized as a component of tax expense.

The effective tax rates for the three and six months ended June 30, 2016 differs from the federal statutory rate of 35% primarily due to the benefit of the earnings in foreign jurisdictions which are subject to lower tax rates.

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, 2017 and 2016, 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 our diluted EPS is similar to the computation of our basic EPS except that the denominator is increased to include the number of additional common shares that would have

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ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(in thousands except per share data)

been outstanding (using the if-converted and treasury stock methods), if our outstanding 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 for the three and six months ended June 30, 2017 and 2016:

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2017	2016	2017	2016
Income from continuing operations, net of income taxes	\$45,873	\$27,254	\$81,314	\$47,474
Basic weighted-average common shares outstanding	39,849	39,672	39,793	39,750
Assumed exercise of dilutive stock options and restricted stock units	401	297	419	296
Diluted weighted-average common shares outstanding	40,250	39,969	40,212	40,046
Continuing operations:				
Basic earnings per share	\$1.15	\$0.69	\$2.04	\$1.19
Diluted earnings per share	\$1.14	\$0.68	\$2.02	\$1.19

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

	Three Months	Six Months
	Ended June 30,	Ended June 30,
	2017	2016
Restricted stock units	1	5

Stock Buyback

In September 2015 our Board of Directors authorized a program to repurchase up to \$150.0 million of our stock over a thirty-month period. As of July 24, 2017, we have \$100.0 million remaining for the authorized repurchase of shares.

NOTE 5. RESTRICTED CASH

As of June 30, 2017, we had \$17.7 million of cash held in restricted escrow accounts to facilitate the July 3, 2017 acquisition of Excelsys Holdings Limited ("Excelsys") (see Note 18. Subsequent Events).

NOTE 6. MARKETABLE SECURITIES AND ASSETS MEASURED AT FAIR VALUE

Our investments with original maturities of more than three months at time of purchase and that are intended to be held for no more than 12 months, are considered marketable securities available for sale.

Our marketable securities consist of certificates of deposit. The relative cost and fair value of our marketable securities are as follows:

	June 30, 2017		December 31, 2016	
	Cost	Fair Value	Cost	Fair Value
Total marketable securities	\$4,095	\$4,096	\$4,735	\$4,737

The maturities of our marketable securities available for sale as of June 30, 2017 are as follows:

	Earliest	Latest
Certificates of deposit	7/28/2017	to 11/27/2017

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ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(in thousands except per share data)

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. As of June 30, 2017, we do not believe any of the underlying issuers of our marketable securities are at risk of default.

The following tables present information about the fair value hierarchy used to measure our marketable securities at fair value, on a recurring basis, as of June 30, 2017 and December 31, 2016. We did not have any financial liabilities measured at fair value, on a recurring basis, as of June 30, 2017 and December 31, 2016.

June 30, 2017	Level		Total
	1	2 3	
Total marketable securities	\$-\$4,096	\$	-\$4,096

December 31, 2016	Level		Total
	1	2 3	
Total marketable securities	\$-\$4,737	\$	-\$4,737

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, 2017.

NOTE 7. 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 currency exchange rate contracts. During the three and six months ended June 30, 2017 and 2016, we entered into currency exchange rate 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 for accounting purposes; however, they tend to offset the fluctuations of our intercompany debt due to foreign currency exchange rate changes. These forward contracts are typically for one month periods. We did not have any currency exchange rate contracts outstanding as of June 30, 2017 or December 31, 2016.

During the three and six months ended June 30, 2017 and 2016 the gains and losses recorded related to the foreign currency exchange contracts are as follows:

	Three Months		Six Months	
	Ended June 30, 2017	2016	Ended June 30, 2017	2016
Foreign currency (loss) gain from foreign currency exchange contracts	\$(666)	\$433	\$(627)	\$(569)

These gains and losses were offset by corresponding gains and losses on the revaluation of the underlying intercompany debt and both are included as a component of Other (expense) income, net, in our Unaudited Condensed Consolidated Statements of Operations.

During the first quarter of 2017 we entered into a foreign currency exchange rate forward contract at a cost of \$3.5 million, to mitigate the exchange rate risk associated with a planned offshore acquisition which was not consummated. This derivative instrument was designated as a hedge for accounting purposes. The hedge expired upon maturity in the first quarter of 2017. The cost of the forward contract is recorded as a component of Other (expense) income, net in our Condensed Consolidated Statement of Operations.

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ADVANCED ENERGY INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(in thousands except per share data)

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 are as follows:

	June 30, 2017	December 31, 2016
Parts and raw materials	\$52,818	\$ 43,278
Work in process	8,766	5,292
Finished goods	13,973	7,200
Inventories	\$75,557	\$ 55,770

NOTE 9. PROPERTY AND EQUIPMENT

Property and equipment are as follows:

	June 30, 2017	December 31, 2016
Buildings and land	\$1,667	\$ 1,581
Machinery and equipment	34,955	32,743
Computer and communication equipment	25,820	24,637
Furniture and fixtures	1,361	1,267
Vehicles	341	357
Leasehold improvements	16,133	