

**DEAR STOCKHOLDERS, CUSTOMERS,  
EMPLOYEES, SUPPLIERS, AND FRIENDS,**

**By nature, I'm an optimist.** As an entrepreneur twenty-five years ago, I had to be. As CEO of this company, known for its innovation, I need to be. And as this company's largest stockholder, I see every reason to be.

As we begin our new fiscal year, we can put two years of difficult change behind us. Years that were fraught with challenges—from macro-economic impediments to self-inflicted delays. They tested our capabilities, but never our confidence. They tempered our successes, but never our spirit. They impacted our profitability—but they never altered our purpose.

As we enter 2005, we now know that change and progress are never as fast as we think they will be—and they are very seldom simultaneous. Oddly enough, that is cause for optimism.

Let's first close out 2004 and then I'll explain.

**Year 2004 results.** Net sales in 2004 increased 51% to \$395.3 million from \$262.4 million for the year 2003. Our net loss for the year was \$12.7 million, or \$0.39 per share, compared with a net loss of \$44.2 million, or \$1.37 per share, in 2003. Gross profit increased to \$119.7 million from \$87.9 million. And gross margin was 30.3% in 2004 compared with 33.5% in 2003.

SG&A expense, without amortization of intangible assets, was \$58.5 million, or 14.8% of sales compared with \$49.4 million, or 18.8% of sales in 2003. Amortization of intangible assets was \$3.9 million for the full year 2004, and \$4.6 million for the full year 2003.

R&D was \$51.5 million in 2004, down fractionally from \$51.6 million for 2003, but as a percent of sales, it declined to 13.0% in 2004 from 19.7% in 2003.

Our balance sheet continues to show strength. We had cash, cash equivalents, and marketable securities of \$108.0 million. And we ended the year with \$206.9 million of working capital, \$396.0 million of total assets, and \$145.0 million of stockholders' equity.

Clearly, we wanted and expected better year-end results. However, we did demonstrate progress. And we believe that with favorable market conditions, progress should accelerate.

**In 2004, China meant change.** Here are two things we know to be true: Change is the only thing that offers new opportunities. And it takes a lot of time, effort, pain, and courage to execute change.

Here are two more things we think to be true: The massive transfer of nineteen of our high-volume, mature product lines to Shenzhen and the alliances formed with Tier One suppliers in Asia, is the largest single China-related manufacturing move undertaken by

anyone in our sector. By the third quarter 2005 we will have twenty-five of our power product lines there—over 80% of our global manufacturing.

It's been a struggle. The cost and operational benefits we anticipated did not come as early as we hoped. For one thing, the extended time it took to make the transition demanded that we maintain duplicate manufacturing capabilities. For another, our Asian supplier network was not completely in place when we started up, making the logistical costs of transporting parts and finished products high.

In hindsight, perhaps if we'd had more experience at this and thoroughly understood the enormity of the project, we would have proceeded differently—but to me, it's a little like entering a deep, cold lake. The short-term shock of an all-out plunge is preferable to the long-term misery of a step-by-step immersion. The sooner you're in, the sooner you swim.

And besides, we're innovators. Innovators, by definition, do something different. What's more, I believe without reservation that there is no greater talent nor more loyal, hardworking employees than the people at AE. If it has to happen, they will make it happen. I've seen it time and again.

And so, having said all that, here is the thing we believe will be true: Our level of presence in China will give AE a significant advantage over our competition through streamlined procurement processes; high quality parts and products; reduced costs and improved response time (especially as more and more of our customers move their own manufacturing facilities into the Pacific Rim); and the earliest relationships with emerging local companies.

We're ready for them. Our OEMs have already qualified our China-made products and our Asian suppliers—and indeed, have been accepting our China-manufactured products for over six months.

Customers who have visited our site in Shenzhen consider it a world-class facility and, in fact, are using it as a model for going into low-cost regions. We also believe that the respect and support we've received from our customers during this transition has made our relationships improve and grow stronger.

**Change for the better.** Sometimes it seemed like the *only* thing we were doing this year is moving to China. But it wasn't. Change has a way of making you refocus—and in our case, it helped us concentrate our R&D efforts.

We changed this year. Instead of reacting to every customer request, which in the past served us well, we're more carefully targeting exactly what we need to do to win in each of the opportunities. We continue to take more than our share of design wins in advanced applications; we continue to dominate in power markets with products such as our Ovation™ very-high frequency power delivery solution, as well as our Navigator™ matching network; and we continue to launch new,

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exciting products, such as our Summit™ direct current power conversion and control system for advanced thin-film manufacturing applications.

Our customers can expect to see more products that capitalize on the unique technical platforms we've developed to meet the needs evolving over the next three to five years. Instead of our products becoming commodities as some feared several years ago, the opposite has occurred. As the geometries get smaller and smaller, the solutions to technical problems involving yields and new processes become harder and harder to devise. This is good news for us. We're at the edge of performance in a lot of areas. Innovative technology is what we do best. Our legacy will continue.

Fort Collins is and will remain our world center for technology development, our key design and launch location. In addition, we will maintain manufacturing space and capability to provide backup for our China operations. In the event of some macro-level disruption, we could be fully operational in Fort Collins within three to five months.

**Change for the future.** Someone said that to be a success in business you need to be daring, you need to be first, and you need to be different. Twenty-five years ago I embraced that notion and launched this company with products that revolutionized a critical part of the semiconductor equipment industry.

Today, we are a long way from that entrepreneurial start-up, but still we continue to cultivate innovation. It is our hallmark. Not confined to groundbreaking technology—it permeates our strategies, our tactics, and our culture. I am immensely proud of that heritage and of the fine people here who carry it on.

There is still hard work to be done, but we believe the worst is behind us. And I am so confident in our continuing growth and success and strength of our position in the industry that I have decided it is time to make a change myself—from CEO to non-executive chairman during 2005.

With that decision has come a renewed realization of what my work here means to me. And more profoundly, what the relationships we've formed with so many interesting, talented, intelligent people mean to my family and me.

Until my successor is named, I will continue to lead our executive team. After that I look forward to contributing my creativity and vision—let's say innovation—to my role as chairman.

**On behalf of everyone at AE, I thank you for your continuing interest and support.**

Douglas S. Schatz

Chairman, President and CEO

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