# IPG Photonics Corporation
# Fourth Quarter 2020 Conference Call Prepared Remarks

**Operator:**

Good morning, and welcome to IPG Photonics' fourth quarter 2020 conference call. Today's call is being recorded and webcast. At this time, I would like to turn the call over to Eugene Fedotoff, IPG's Director of Investor Relations, for introductions. Please go ahead sir.

**Eugene Fedotoff:**

Thank you operator, and good morning everyone. With us today is IPG Photonics' Chairman and CEO, Dr. Valentin Gapontsev, Chief Operating Officer, Dr. Eugene Scherbakov and Senior Vice President and CFO, Tim Mammen. Statements made during the course of this call that discuss management's or the company's intentions, expectations or predictions of the future are forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause the company's actual results to differ materially from those projected in such forward-looking statements. These risks and uncertainties include the impact of the COVID-19 pandemic on our business and those detailed in IPG Photonics' Form 10-K for the period ended December 31, 2019 and other reports on file with the Securities and Exchange Commission. Copies of these filings may be obtained by visiting the Investors section of IPG's website or by contacting the company directly. You may also find copies on the SEC's website.

Any forward-looking statements made on this call are the company's expectations or predictions as of today, February 16, 2021, only. The company assumes no obligation to publicly release any updates or revisions to any such statements. For additional details on our reported results, please refer to the earnings press release and the Excel-based financial data workbook posted on our investor relations website. We will post these prepared remarks on our investor relations website following the completion of this call. With that, I'll now turn the call over to Valentin.

**Valentin Gapontsev:**

Good morning everyone. We are very pleased with our fourth quarter results as we delivered revenue that was 10% higher than the fourth quarter 2019, and above our guidance range. In addition, book-to-bill was above one in the fourth quarter as we saw the traction in order flow that started in the third quarter continue during the fourth quarter and into 2021. We are continuing to benefit from the advantages of our leading-edge products, technology differentiation, low-cost production capabilities and global footprint.

We continued to see strong revenue in China, which was significantly higher on a year-over-year basis as volume growth more than offset lower selling prices in the region. We were also pleased to see a sequential improvement in revenue in Europe and strong sequential revenue growth in North America in the fourth quarter. Our systems sales also improved modestly, but continue to be below last year, primarily due to the impact on the economy from COVID-19.

We are demonstrating good progress in our core markets thanks to our technology differentiation and low cost production capabilities. In high power lasers, we delivered strong year-over-year growth in both our rack mounted 1 to 4 kW lasers for the high-volume market and our ultra-high power lasers for leading-edge cutting systems as sales of lasers above 6 kilowatt increased 34% compared to the fourth quarter 2019 and were 56% of total high power sales. At the high end of the market, we are benefiting from an increase in order volumes for our 20 and 30 kW ultra-high power lasers and optical heads. These lasers not only enable 50% to 100% faster cutting speeds than a 15 kW device, but are capable of processing materials with 20 to 50 millimeters of thickness or greater. This improvement in productivity and flexibility coupled with superior beam

parameters, record wall plug efficiency, and reliability is driving the replacement of plasma cutting machines, other non-laser solutions and lower power laser solutions.

We booked the first orders for the new unique ultra-compact rack mounted U series of lasers for low-cost cutting systems, and we expect to start shipping them shortly in volume. Not only do these lasers provide extended optical performance, record power-to-volume ratio and full protection against humidity, they are also significantly lower in cost to manufacture. As a result, we expect this new design to improve gross margin for these products.

We continue to focus on growing sales in other applications that are outside of our traditional cutting and welding markets.

Last quarter we launched our revolutionary and innovative handheld laser welding system and the initial customer response has been extremely positive. We believe this system has great potential for IPG as it replaces traditional handheld welding products used in metal fabrication like MIG and TIG. The product offers orders of magnitude higher quality welding and speed, much greater precision, flexibility, and ease of use to our customers around the world. In addition, for the first time, the product will simultaneously provide the highest quality pre-cleaning and after-cleaning of the weld surface and weld itself, respectively. We have already sold a number of units in the last few weeks only and believe that there are thousands of customers in the US alone, and many tens of thousand worldwide that could be interested in this unique product.

During the fourth quarter emerging product and application sales were 28% of total revenue, increasing 22%. We were pleased with the performance of a number of products that are the key to the diversification of our revenue. Examples include, high power nanosecond pulsed lasers

used for foil cutting and cleaning in electric vehicle battery processing as well as for ablation and cleaning; sales of medical lasers and consumable medical fibers, our "gold standard" thulium laser solution for urology; and, green laser sales for solar cell processing. With record backlog, we expect sales of green lasers to continue to grow fast as our green pulsed lasers are enabling significant improvements in solar cell efficiency. In addition, high power lasers for defense applications performed well year over year. Despite the impact of the pandemic, ultraviolet and ultrafast pulsed lasers into emerging micro-processing applications showed strong growth for 2020.

Our Adjustable Mode Beam (AMB) lasers continue to gain traction in the welding industry, most notably in electric vehicle battery welding, and, as a result, we received significant orders for AMB lasers in Q4. Our AMB products offer superior speed and weld quality over competing solutions thanks to the broadest range of beam tunability which enables spatterless welding.

The multichannel QCW lasers for high-speed spot welding applications bring significant cost savings due to an increase in welding productivity and decrease in electrical consumption. Beyond materials processing, we continue to develop new soft tissue medical treatments, mid-infrared lasers for molecular-level resolution online spectroscopy, inspection, sensing and biomedical research applications. In addition, we are continuing development of our new generation of analog and coherent digital silicon photonic devices for super high speed and highest volume data processing for telecom, datacom, and many other advanced future applications. Furthermore, we were extremely pleased by the growth we saw in advanced applications and medical applications.

Research and development has been a driving force behind IPG's success since the company's inception.  We spent over 10% of our total revenue on R&D in 2020 and have over 650 people in research and development, including many scientists and engineers, who continue to develop new leading-edge solutions for our customers, helping drive efficiency and productivity in their operations and making our fiber laser technology the tool of choice in mass production for more than 20 year.

I would like to thank our employees for their strong execution during our fourth quarter despite the continuing challenging operating environment.  As always, the well-being of our employees, their families, our customers, our partners and communities we operate in remains our highest priority.

With that, I'll turn the call over to Eugene.

**Eugene Scherbakov:**

Thank you Valentin, and good morning. The impact of COVID-19 on our production capabilities continues to be minimal and we are focused on ensuring the safety of our employees with social distancing and enhanced cleaning and filtration measures in place; otherwise, we are operating normally. Despite the increase in COVID-19 cases in the Northern Hemisphere with the Fall and Winter, production has remained fully operational and we managed COVID-related absences effectively.

We were very pleased with the performance of operations during the fourth quarter as production ramped to meet the increase in demand enabling us to exceed the top end of our guidance range, and report the first quarter of year-over-year growth in more than two years.

We are proud of the improvement in the underlying gross margin driven by an increase in revenue, product cost reductions, and product mix improvement.

Total SG&A and R&D expenses were $76 million in the fourth quarter and continue to benefit from lower travel and trade show expenses given pandemic-related restrictions. As the business activities start to pick up and some restrictions are lifted and life normalizes in the second half of 2021, we would expect our operating expenses to increase as well. We remain committed to supporting our R&D while controlling total operating expenses to drive operating leverage for the company. We continue to benefit from reducing the cost of devices, our vertical integration and from the expense reduction initiatives we undertook in the second half of 2019.

Examining our performance by region, revenue in China increased 52% year over year, representing approximately 42% of total sales. Demand and order flow in China remained resilient during the quarter and orders booked in 2021 prior to Chinese New Year have been strong. While we face aggressive competition in the region, we believe that our products have superior performance and reliability and we are seeing strong growth in demand for our ultra-high power lasers.

In Europe, while revenue decreased 5% year over year due to the effects of COVID-19, it did grow sequentially. In addition, in Europe order flow continued to get better despite the increased restrictions in Europe due to lockdowns. Similarly, revenue in North America decreased 11% year over year but grew 37% on a sequential basis with a good improvement in materials processing sales for lasers and systems and year-over-year growth in medical and advanced applications. North American bookings continued to be strong even relative to the exceptional order flow in Q3 2020. Sales in Japan decreased 29% year over year. While the economy in the region continues to be negatively impacted by COVID-19, some regional macroeconomic indicators have improved in the recent months. Sales to the rest of Asia increased 3% year over year, continuing to recover from the second quarter trough, and also benefited from the shipment of green lasers for renewable energy. Sales in Turkey decreased 2% year over year and grew 21% sequentially.

Economic indicators continue to show improvement from the significant contraction earlier in the year, and this is one factor behind the improving direction of our business. In addition, it seems that there is some optimism for an improving investment cycle driven by equipment upgrades related to requirements for flexible processing,

automation and energy efficiency. Our leading-edge fiber laser technology offers significant productivity gains, electrical efficiency and lower total cost of ownership over other lasers and non-laser tools. An increasing focus on the environmental impact and commitments to net zero emissions by large industrial manufacturers is creating additional opportunity for our lasers and bodes well for our long-term growth objective. We are already starting to see it with the electrical vehicles and electrical vehicle battery production and are likely to see it with other industries. We believe that efficiency is likely to become a more meaningful driver in displacing processes that are energy intensive such as plasma cutting and legacy welding processes. Despite the challenging operating environment that we faced in 2020 due to COVID-19, we believe that we are well positioned as we enter year 2021.

In addition, we continue to believe that the breadth and depth of our product offering, our large and diverse advanced materials and components technology platform, our efficient R&D model, our strong balance sheet and free cash flow provide us ample flexibility to respond to business disruptions.

With that, I'll turn the call over to Tim to discuss financial highlights in the quarter.

**Tim Mammen:**

Thank you Eugene, and good morning everyone.

Revenue in the fourth quarter was $337 million, and increased 10% year over year driven by growth from most of our key product lines. Revenue from materials processing applications increased 10% year over year and revenue from other applications increased 12%. Sales of high power CW lasers increased 17% and represented approximately 55% of total revenue. Sales of ultra-high power lasers above 6 kW represented 56% of total high power CW laser sales. Pulsed lasers sales increased 55% year over year, with strong growth driven by high power nanosecond pulsed lasers used in EV battery manufacturing, green pulsed lasers used in solar cell manufacturing as well as higher sales of our new UV and ultrafast pulsed lasers which were partially offset by lower sales of lower-power pulsed lasers for marking applications. Systems sales decreased 20% year over year due to COVID-19 but did improve sequentially. Medium power laser sales increased 25% as there was some recovery in additive manufacturing and other fine processing applications. QCW laser sales decreased 16% year over year due to lower sales for aerospace drilling applications. Other product sales decreased 11% year over year due to lower telecom sales.

Q4 gross margin was 44%, which increased 310 basis points year over year. The additional inventory charge reduced gross margin by 410 basis points. Excluding this impact, gross margin benefited from lower cost of products and a decrease in unabsorbed costs as a percentage of sales as compared to the year-ago period. The additional inventory charge of $14 million was related to optical components that have been replaced by components with better performance.

Fourth quarter GAAP operating income was $65 million and operating margin was 19%. During the quarter we recognized a foreign exchange loss of $5 million primarily related to the depreciation of the US dollar versus the Euro. Q4 net income was $49 million, or $0.92 per

diluted share. The additional inventory charge and foreign exchange loss reduced EPS by $0.27. The effective tax rate in the quarter was 24%.

If exchange rates relative to the US Dollar had been the same as one year ago, we would have expected revenue to be $12 million lower and gross profit to be $8 million lower.

We ended the quarter with cash, cash equivalents, and short-term investments of $1.4 billion and total debt of $38 million. Strong operational execution resulted in cash provided by operations of $85 million during the quarter. Capital expenditures were $26 million in the fourth quarter. We expect 2021 capital expenditures will be in the range of $150 million to $160 million for the full year. Total capital expenditures in 2020 were significantly below our initial budget as we delayed some projects and some of these projects are now scheduled for 2021. 2021 capex includes facilities and equipment expenditure for production, R&D and sales activity to support our future growth. During the quarter we did not repurchase any shares.

In total, fourth quarter book-to-bill was above 1, and we were pleased with order flow across all of our main geographic regions. Geographically, most areas continue to show improvement with the only area that remains weak being Japan.

For the first quarter of 2021, IPG expects revenue of $310 to $340 million. The Company expects the first quarter tax rate to be approximately 25%. IPG anticipates delivering earnings per diluted share in the range of $0.90 to $1.20, with 53.2 million basic common shares outstanding and 53.9 million diluted common shares outstanding.

The improvement in macroeconomic indicators is now more broad based, and if sustained, gives us optimism for 2021. However, we are a little cautious given the resurgence of COVID-19 in Europe and North America, as well as the uncertainty surrounding vaccination roll out and return to normalcy is unclear at this time. These uncertainties continue to make forecasting our business challenging in the medium term and our first quarter guidance remains subject to significant uncertainties, including the impact on the global business environment and expected recovery from COVID-19, economic trends, growth from emerging product revenue, competition and the lack of long-term binding order commitments.

That said we continue to benefit from near-term growth opportunities in ultra-high power cutting, electric vehicle battery processing, renewable energy, micro-processing, medical procedures and advanced applications. We believe the strides we are making in higher-power products within our core materials processing business and new solutions are enhancing our competitive position.

As discussed in the "Safe Harbor" passage of today's earnings press release, actual results may differ from our guidance due to factors including, but not limited to, goodwill and other impairment charges, product demand, order cancellations and delays, competition, tariffs, trade policies, health epidemics and general economic conditions. Our guidance is based upon current market conditions and expectations, assumes exchange rates referenced in our earnings press release, and is subject to risks outlined in the company's reports with the SEC.

With that, Valentin, Eugene and I will be happy to take your questions.

**Eugene Fedotoff:**

Thank you for joining us this morning and for your continued interest in IPG. We look forward to speaking with you over the coming weeks and will be participating in a number of virtual investor conferences this quarter. Have a great day everyone.