IPG Photonics Corporation
Second Quarter 2021 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' second quarter 2021 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' Executive Chairman, Dr. Valentin Gapontsev, Chief Executive 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, 2020 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, August 3, 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 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 pleased to report another good quarter for IPG. Our second quarter revenue was significantly above the same period last year and increased from strong results in the prior quarter, driven by improved macroeconomic conditions in most major geographies, growth in emerging products as well as excellent execution by the IPG team. We saw higher end-market demand for our core materials processing products, where our fiber lasers are replacing traditional tools and other lasers, and continued to pursue the opportunities in emerging markets. We remain focused on growing sales in applications that require innovative solutions, our expertise in fiber laser technology and superior quality of products such as advanced applications, electric vehicle battery production, medical and micro processing. Our technologies are transforming the way products are created, enabling production of smaller and more complex devices, improving the products we use everyday, and bringing advanced manufacturing capabilities to electric vehicle and renewable energy industries, helping to address climate change and sustainability initiatives. Our investments in new products and the applications are paying dividends. In the second quarter, emerging products sales increased 47% year over year and accounted for 29% of sales compared to 25% last year. We continue to focus on innovation at IPG and are working on tens of exciting opportunities. I hope to share more details about these opportunities with you on our future calls.

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

Eugene Scherbakov:

Thank you Valentin, and good morning everyone. During the quarter, we demonstrated excellent progress in our core materials processing markets across all major geographies with accelerated growth in high power and ultra-high power lasers for cutting applications in U.S. and Europe and strong growth in welding in China and Europe. We also delivered robust growth in emerging products and applications.

Revenue from materials processing applications increased 27% year over year and contributed 93% of total revenue in the quarter. Sales in welding applications grew significantly in the last several quarters due to increased sales of our AMB lasers for general manufacturing purposes and electric vehicle battery welding applications. Battery manufacturers are facing challenges welding together different types of materials such as copper and aluminum. These materials are extremely thin, reflective and need to be welded with high precision and reliability. Each battery module requires hundreds of welds and our AMB lasers can address these challenges, offering superior speed and weld quality over competing solutions with a broad range of beam tunability and spatterless welding.

We also saw strong demand in marking and micro materials processing applications such as solar cell manufacturing and 3D printing. Sales of our green pulsed lasers, which are used to improve solar cell efficiency, more than tripled compared to the prior year and becoming a more meaningful part of IPG's revenue. We are taking advantage of the opportunities created by increasing focus on sustainability globally and expect future solar cell manufacturing capacity to grow, driving additional sales of our green

lasers. We are also increasing the pulse energies of green lasers to enable next generation applications in solar, drilling and copper welding for consumer electronics.

Revenue from other applications increased by 5% year over year. Medical sales showed good growth both year over year and sequentially as a result of improved demand for our surgical lasers. Advanced applications sales improved year over year while telecom revenue declined compared to the same period in the prior year.

Examining our performance by region, our revenue in China increased 10% year over year in the second quarter, representing approximately 43% of total sales. Year-over-year comparison for the region was more difficult as China sales rebounded from the pandemic earlier than other regions last year. We saw strong demand in welding applications for our AMB and other high power lasers while demand in cutting softened at the end of the quarter so that sales of high power lasers increased only slightly compared to the second quarter last year. We continue to see solid demand in foil cutting and welding applications related to electric vehicle batteries and are also starting to see some demand for the LightWELD handheld laser welding system in China, which should provide a modest benefit to revenue in the second half.

While China's market remains very price competitive, we have continued to be disciplined with our approach to pricing given superior performance, quality, energy efficiency and reliability of our lasers. However, there remains a significant part of the customer base that is very focused on price alone.

Sales to the rest of Asia increased 123% year over year with strong growth in Korea and other countries offsetting lower revenue in Japan. We are seeing strong demand for our welding and foil cutting solutions for EV batteries in Korea and are encouraged by improved bookings in Japan.

In Europe, revenue increased 50% year over year as we saw an acceleration of demand from customers in the region and strong growth in cutting, welding, marking and cleaning applications. Sales improved significantly in high power, ultra-high power, AMB and QCW lasers. European cutting customers are moving into ultra-high power lasers and are replacing CO2 lasers with fiber lasers to improve productivity. Bookings for the region remain positive, pointing to a continued recovery.

Revenue in North America increased 23% year over year. Growth was primarily driven by materials processing and increased sales of high power lasers for cutting applications. Sales to automotive, both traditional and electric, and solar markets remained strong. We also saw solid improvement in micro materials processing applications and strong growth in demand for LightWELD. Besides our normal direct sales model, we are leveraging new third party resellers with numerous welding stores and a new direct online sales platform for LightWELD in U.S.

Laser systems sales improved in the second quarter with both laser and non-laser systems posting strong revenue growth. Bookings remain high and we expect to see additional improvement in systems sales in the third quarter.

We continue to benefit from our vertically integrated production model which enables key technological advantages over the competition while minimizing costs and supply chain disruptions. However, we did experience shortages of certain components during the quarter and saw increasing lead times that are impacting our and our customers' operations. We are also evaluating inflationary pressures on our input costs and will re-evaluate prior quotations when they expire. Despite these headwinds, we were able to deliver revenue close to the midpoint of our guidance and gross margin close to the top of our expectations for the second quarter.

IPG has been a technology leader in fiber lasers for more than 20 years and none of our competitors have been able to match or approach the capabilities of our products. Research and development is in our DNA and we are continuing to focus on reducing the cost and improving the quality of our components and products. We are also committed to expanding the range of products and applications we address by pursuing research and development projects we believe we can commercialize in the near to mid-term which have a significant market potential. We will continue to focus on opportunities where we can increase our value proposition to customers by delivering complete processing and technology solutions with our optical delivery and systems capability.

I want to thank our employees for their execution during the second quarter and thank our shareholders for your continued support. With that, I'll turn the call over to Tim to discuss financial highlights in the quarter and third quarter outlook.

Tim Mammen:

Thank you Eugene, and good morning everyone.

Revenue in the second quarter was $372 million, which increased 25% year over year and 8% sequentially. Revenue from materials processing applications increased 27% year over year and revenue from other applications increased 5%. Sales of high power CW lasers increased 20% year over year and represented approximately 51% of total revenue. Sales of ultra-high power lasers at 6 kilowatt or greater represented 51% of total high power CW laser sales and increased 15% compared to the prior year. Medium power laser sales increased 70% on growth in cutting, welding, 3D printing and semiconductor applications. QCW laser sales increased 13% year over year on higher demand from welding applications. Pulsed lasers sales increased 45% year over year, with strong growth in green pulsed lasers used in solar cell manufacturing and higher sales of our infrared lasers for marking and cleaning applications as well as foil cutting applications in the electric vehicle batteries manufacturing process. Systems sales increased 19% year over year with improved sales for Genesis and ILT. Other product sales decreased 4% year over year. We estimate that supply chain constraints impacted our revenue by $7 to $10 million in the quarter.

Second quarter GAAP gross margin was 48.6%, an increase of 260 basis points year over year. Compared with the year-ago period, the increase in gross margin was driven primarily by improved absorption of manufacturing expenses, partially offset by lower pricing and higher shipping costs as a percent of sales.

GAAP operating income was $92 million and operating margin was 24.8%. Second quarter net income was $70 million, or $1.29 per diluted share. The effective tax rate in the quarter was 24%.

During the quarter we recognized a foreign exchange loss of $3 million primarily related to appreciation of Russian Ruble and Euro, partially offset by appreciation of Chinese Yuan. The foreign exchange loss reduced EPS by $0.04.

If exchange rates relative to the U.S. Dollar had been the same as one year ago, we would have expected revenue to be $23 million lower and gross profit to be $13 million lower.

We ended the quarter with cash, cash equivalents, and short-term investments of $1.5 billion and total debt of $36 million. Strong operational execution resulted in cash provided by operations of $116 million during the quarter. Capital expenditures were $27 million in the second quarter and we now expect capital expenditures to be between $130 and $150 million for the full year. During the quarter we repurchased 185 thousand shares for $39 million.

Commenting on outlook for the next quarter, second quarter book-to-bill remained above one. While we expect continued improvements in sales outside of China, sales in China are likely to moderate in the third quarter due to more difficult comparisons and softer demand in cutting applications. However, displacement of non-laser technologies, secular environmental trends and investments we have made in emerging products, mean that we continue to see growth opportunities in high power cutting, foil cutting and welding applications for electric vehicle battery production, as well as opportunities in solar cell manufacturing, medical procedures and advanced applications. We also see LightWELD sales gaining traction in multiple geographies in the second half.

For the third quarter of 2021, IPG expects revenue of $350 to $380 million, which implies a 15% growth year over year at the midpoint despite more difficult third quarter year-over-year comparison, softness in the cutting market in China, and ongoing supply chain constraints. The Company expects the third quarter tax rate to be approximately 25%, excluding any discrete items. IPG anticipates delivering earnings per diluted share in the range of $1.10 to $1.40, with 53.5 million basic common shares outstanding and 54.0 million diluted common shares outstanding.

I would like to remind you that financial guidance provided this quarter continues to be subject to greater risk and uncertainty given the COVID-19 pandemic and its associated impacts to the global business environment, public health requirements and government mandates. Please refer to the "Safe Harbor" passage of today's earnings press release for more details on risks and uncertainties associated with our forward-looking statements.

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 events this quarter. Have a great day everyone.