IPG Photonics Corporation
Third Quarter 2021 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' third 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' 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, November 2, 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, earnings call presentation 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 Eugene Scherbakov.

Eugene Scherbakov:

Thank you Eugene, and good morning everyone.

We are deeply saddened by the passing of Valentin Gapontsev, the founder and Executive Chairman of IPG. This is a tremendous loss for our company and the broader photonics community, which benefited greatly from his technical innovations and strategic vision. Because of his vision and relentless work, fiber lasers have become cost-effective, reliable and effective tools that have mass applications in global industrial production, enabling automation, efficiency and development of new products. He was recognized as the Father of the Fiber Laser Industry and a great entrepreneur. Following his footsteps, we will continue to focus on innovation and invest internally in manufacturing and research and development capabilities to make the highest quality components and the most reliable products.

At IPG, we are also exploring new markets and applications where fiber lasers can replace existing laser and non-laser technologies by improving efficiency, productivity, or enabling technological breakthroughs for our customers. Our technologies are playing well into the major macro trends that include investments in electric vehicles and renewable energy, as well as the focus on energy efficiency, industrial automation and miniaturization, which are transforming the way products are created. As a part of our strategy, we have been diversifying away from the highly competitive and more cyclical cutting market in China and our results this quarter demonstrated successful execution of this strategy.

We are pleased to deliver third quarter revenue and EPS at the top end of our guidance. Results were driven by strong growth in welding, marking, 3D printing, as well as cleaning, semiconductor and a number of other new products and applications. Demand for IPG lasers continued to improve in North America and Europe with both welding and cutting applications showing solid growth. We are also seeing increased orders and business activity in Japan. These geographies continue to recover from the pandemic and saw increased investments in new factories and automation.

We are benefiting from widespread investments in electric vehicle production globally. Our lasers are used in a variety of welding, foil cutting and cleaning applications for EV battery manufacturing. We are also seeing opportunities for laser welding in EV motor assembly and body-in-white applications. These investments are likely to continue for the next 3 to 5 years as automotive manufacturers address the need for EV batteries and new technologies in order to meet aggressive global carbon emission standards.

We are excited about increased demand we are seeing in emerging products and applications, which contributed just under 30% of our total revenue this quarter with record sales in AMB lasers and medical, and strong growth in high power pulsed lasers. Both AMB and high power pulsed lasers are benefiting from increased investments in EV battery capacity worldwide.

Our medical products are rapidly gaining adoption and both our thulium laser and IPG disposable fibers are considered new gold standard in the industry. We believe that our medical business will continue to grow significantly, potentially doubling in size over the next 2 to 3 years.

One of our newest products, the handheld laser, which was launched earlier this year, is winning widespread interest and gaining significant traction in the welding community. We launched our new and improved version of LightWELD in September. It also has cleaning capability in addition to many preset welding parameters. Some customers may choose LightWELD just for this cleaning feature as it can save time, money and reduce costly consumables. LightWELD was the highlight of our presentation at Fabtech this year and we have signed agreements with nationwide distributors that operate hundreds of welding retail stores in the United States. We currently expect to sell tens of thousands of LightWELD systems in the next 3 to 5 years.

As expected, we saw softer demand conditions in China cutting market during the third quarter. The combination of a moderated demand environment driven by widespread supply chain issues, higher shipping costs and power shortage as well as more aggressive price competition from local manufacturers negatively impacted demand for cutting applications in China during the quarter. At the same time, we are seeing record demand in welding in China, as a result of strong sales in EV battery applications, and increased revenues for marking and 3D printing. In several cases, we saw customers coming back to IPG after low-cost local suppliers did not meet customers' quality and technical support expectations.

We continue to benefit from our vertically integrated product model which enables technological advantages while minimizing supply chain disruptions. However, we have been seeing some impact on our and our customers' operations from the ongoing supply chain issues worldwide, which we were able to successfully overcome this quarter.

As we announced earlier, the Board selected John Peeler as non-executive Chair. John has served as lead independent director since 2017 and his appointment provides continuing stability as we have worked together well over the years. This appointment continues the separate CEO and Chair roles that started in May 2021 and I look forward to working with John in his new position.

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

Tim Mammen:

Thank you Eugene, and good morning everyone. My comments generally will follow the earnings call presentation which is available on our website. I will start with the financial review on slide 3.

Revenue in the third quarter was $379 million, which increased 19% year over year and 2% sequentially.

Third quarter GAAP gross margin was 49.0%, an increase of 100 basis points year over year. Compared with the year-ago period, the increase in gross margin was driven primarily by lower inventory provisions and a reduction of unabsorbed manufacturing expenses as a percent of sales.

GAAP operating income was $102 million and operating margin was 26.9%. Third quarter net income was $75 million, or $1.40 per diluted share. The effective tax rate in the quarter was 26%.

As a reminder, last year's results were negatively impacted by a goodwill impairment charge of $45 million.

During the quarter, we recognized an after-tax foreign exchange gain of $2 million or $0.04 per diluted share, primarily related to the depreciation of Euro and Chinese Yuan.

If exchange rates relative to the U.S. Dollar had been the same as one year ago, we would have expected revenue to be $9 million lower and gross profit to be $6 million lower.

Moving to slide 4, sales of high power CW lasers decreased 4% year over year and represented approximately 47% of total revenue. Sales of ultra-high power lasers at 6 kilowatt or greater represented 51% of total high power CW lasers. Medium power laser sales increased 109% on

growth in cutting, welding, 3D printing and semiconductor applications. QCW laser sales increased 8% year over year on higher demand from marking and engraving and drilling applications. Pulsed lasers sales, including high power pulsed lasers, increased 69% year over year, with strong growth in foil cutting applications for EV battery manufacturing, solar cell applications as well as higher sales of our infrared lasers for marking and cleaning. Systems sales increased 56% year over year with improved revenues for Genesis and ILT and a ramp-up in LightWELD sales. Other product sales increased 58% year over year, benefiting from higher sales in medical and beam delivery.

Examining our performance by region on slide 5, revenue in North America increased 55% year over year, driven by materials processing with growth in welding and increased sales of high power lasers for cutting applications. We also saw record quarterly revenue in medical as our products continued to gain acceptance. Systems sales improved in the third quarter with both laser and non-laser systems posting strong revenue growth.

In Europe, revenue increased 50% year over year driven by accelerated demand in cutting and welding applications, as well as strong growth in marking and additive applications.

Our revenue in China decreased 7% year over year in the third quarter, representing approximately 36% of total sales. Soft sales of high power lasers in cutting applications more than offset higher demand in welding applications, high power pulsed lasers for foil cutting, and growth in marking and additive applications.

Sales in Japan were up 11% and revenue in the rest of Asia increased 15% year over year.

Moving to a summary of our balance sheet and cash flow on slide 6. We ended the quarter with cash, cash equivalents, and short-term investments of $1.5 billion and total debt of $35 million. Strong operational execution resulted in cash provided by operations of $102 million during the

quarter. For our cash deployment, capital expenditures were $40 million in the third quarter and we expect capital expenditures to be between $130 and $150 million for the full year. During the quarter we repurchased 200 thousand shares for $36 million and have bought approximately 135 thousand additional shares so far in the fourth quarter.

Commenting on outlook for the next quarter, third quarter book-to-bill remained above one. We expect stable demand in North America and Europe and continue to see growth opportunities in welding and high power cutting in North America and Europe, foil cutting and welding applications for EV battery production across many geographies, as well as opportunities in solar cell manufacturing, medical procedures and advanced applications. We also see LightWELD sales continue to gain traction. However, sales in China will be down sequentially in the fourth quarter due to softer demand in cutting applications, uncertainty due to supply chain issues and power outages that may impact demand for our products as well as ongoing competitive pressures.

For the fourth quarter of 2021, IPG expects revenue of $330 to $360 million. The Company expects the fourth quarter tax rate to be approximately 25%, excluding any discrete items. IPG anticipates delivering earnings per diluted share in the range of $1.00 to $1.30, with approximately 54 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, supply chain, 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.

And with that, we 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.