IPG Photonics Corporation
First Quarter 2023 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' first quarter 2023 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 me today is IPG Photonics' CEO, Dr. Eugene Scherbakov and Senior Vice President and CFO, Tim Mammen. Let me remind you that 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 are detailed in IPG Photonics' Form 10-K for the period ended December 31, 2022 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, May 2, 2023, 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 investor relations website following the completion of this call. With that, I'll now turn the call over to Eugene Scherbakov.

Eugene Scherbakov:

Good morning everyone. We are pleased with our results this quarter, which were above our guidance range despite macroeconomic uncertainty that continued to negatively impact demand in general industrial applications such as cutting and marking. We reported another quarter of solid revenue growth in welding that was driven by record sales in EV applications and all-time high revenue for our handheld welder, LightWELD. Additionally, we saw strong results in cleaning and solar cell manufacturing. Demand for these products is driven by global macrotrends and increasing investments in renewable energy and eco-friendly solutions. IPG is developing innovative technologies that enable manufacturing of these products and improve speed and efficiency, with benefits to society and environment. Recently, we published our 2023 annual sustainability report on our website providing information on many of these trends and how IPG delivers on our new mission statement, "applying light in ways that improve life."

IPG has been making good progress in diversifying our revenue and reducing our exposure to cyclical and economically sensitive industrial markets. While these markets and applications still account for a major portion of IPG's revenue, we have been investing our R&D, sales and operating resources to support growth of emerging products and to drive further diversification of our revenues. In the first quarter, emerging growth product sales grew both sequentially and year over year and accounted for 45% of total sales. Many of these products are benefiting from global investments in e-mobility and renewable energy. We saw another quarter of record sales in AMB lasers, driven by growth in EV battery welding as global EV battery capacity build-out continued. We also saw increased demand for our green lasers that are used in solar cell

manufacturing applications, improving efficiency of these solar cells. We expect investments in solar cell capacity globally to drive increasing demand for our green lasers in the future.

Additionally, our revenue for lasers used in cleaning applications grew significantly in the first quarter. Laser cleaning solutions provide sustainability benefits by reducing the use of abrasives and harmful chemicals. For example, a customer is evaluating replacing acid etching with our cleaning lasers. In addition to the environmental benefits, laser cleaning can significantly reduce costs of storage, transportation and handling toxic chemicals and eliminate reliance on consumables, which leads to reduced operating expenses. Our recently-introduced laser drying and heating solutions are replacing less-efficient infra-red bulbs. The solutions are well-received by customers and are gaining market acceptance because they cut down on energy consumption and environmental impact. We expect orders for these systems in the second quarter and anticipate strong demand for drying systems in the future.

IPG had another quarter with record sales in e-mobility applications. We are seeing customers accelerating investment in EV battery capacity in North America, Europe, Japan and Korea in addition to the investments being made in China. Our e-mobility business in the U.S. has increased substantially in the first quarter as customers shifted investments into the region to take advantage of government incentives. We offer a broad range of solutions to customers from laser sources to complete production lines for existing and emerging battery technologies. Our real-time weld monitoring solutions and adjustable mode beam lasers create an industry leading combination and addresses customers' challenges and provides superior weld quality for hundreds of welds in each battery pack. We continue to explore additional opportunities for welding components in electrical motor assembly. With the strong pipeline of opportunities we are expanding our global sales force focused on e-mobility applications. We expect the EV investment cycle to continue and e-mobility sales to remain strong in the next 3 to 5 years

although demand can fluctuate depending on the pipeline of projects and regional capacity additions.

Our medical business had a good quarter and grew year over year driven by continued adoption of our laser system and consumable fibers for urology applications. However, we expect medical sales will be softer in the second quarter as a large customer adjusts its buffer inventory. We are working on multiple new opportunities to broaden our medical portfolio and to further grow the business so it becomes a more meaningful contributor to IPG sales in the next 2 to 3 years.

I would like to thank our employees for their dedicated work. We believe that an engaged and diverse workforce is a great strength of our organization. IPG has always focused on inclusion and employs a large number of women and workers from diverse backgrounds. To further improve our diversity, for the first time, we announced targets in our recent CSR report to increase gender diversity and minority representation in the global workforce and management roles. We strongly believe that an inclusive workplace creates a better future for our company and the communities we operate in.

I'll now turn the call over to Tim to discuss financial highlights in the quarter.

Tim Mammen:

Thank you Eugene, and good morning everyone. My comments generally will follow the earnings call presentation which is available on our investor relations website. I will start with the financial review on slide 4.

Revenue in the first quarter was $347 million, a decline of 6% year over year due to foreign currency headwinds, which accounted for approximately 4% of the decline and telecom divestiture that reduced revenue by approximately 1%. Revenue from materials processing applications decreased 8% year over year, while revenue from other applications increased 10%.

GAAP gross margin was 42.3%, a decrease of 410 basis points year over year, due to increased manufacturing costs, higher inventory reserves as well as higher shipping costs and tariffs, which was partially offset by an improvement in absorption as a percentage of sales. On a sequential basis, gross margin did show some improvement.

FX also had a negative impact in the quarter. If exchange rates relative to the U.S. dollar had been the same as one year ago, we would have expected revenue to be $15 million higher and gross profit to be $8 million higher.

GAAP operating income was $75 million and operating margin was 21.7%. Net income was $60 million, or $1.26 per diluted share. The effective tax rate in the quarter was 28% and was impacted by certain discrete items.

Foreign currency transaction gains related to remeasuring foreign currency assets and liabilities to period-end exchange rates, had a positive impact on operating income of $3 million and positively benefited earnings per share by $0.06. Excluding the currency transaction gain and a small restructuring charge, operating expenses declined year over year, primarily in research

and development as we reduced spending on telecom product development as well as reduced expenses from the sale of the corporate aircraft last year.

Moving to slide 5. Sales of high power CW lasers decreased 8% and represented approximately 44% of total revenue. Sales of ultra-high power lasers above 6 kW represented 42% of total high power CW laser sales. The decline was primarily due to lower demand in high power cutting applications due to softer demand and competition in China, which was only partially offset by growth in welding. Pulsed lasers sales decreased 16% year over year as strong growth in cleaning and solar cell applications was offset by lower demand in cutting and marking applications. Systems sales increased 20% year over year driven by growth in laser-based systems and LightWELD. Medium power laser sales decreased 42% while QCW laser sales were down 12% year over year, negatively impacted by lower sales to consumer electronics applications. Other product sales increased driven by strong medical sales and increased revenue in advanced applications.

Looking at our performance by region on slide 6, revenue in North America decreased by 1%, due to the telecom divestiture. Growth in welding, cleaning, advanced applications and medical applications was strong in the quarter and offset lower cutting revenue.

In Europe, sales decreased 7% as a result of difficult comparisons as some growth in the first quarter of the prior year was attributed to pull forward of demand from the second quarter due to supply chain concerns. However, European revenue increased sequentially despite overall uncertainty in the economy.

Revenue in China decreased 22% year over year as growth in welding for EV battery applications and cleaning applications was offset by continued softness in the cutting market and lower demand in marking applications.

Moving to a summary of our balance sheet on slide 7, we ended the quarter with cash, cash equivalents, and short-term investments of $1.1 billion and total debt of $16 million. Cash provided by operations was $37 million during the quarter and capital expenditures were $33 million in the quarter. First quarter cash provided by operations is typically low due to bonus and tax payments. Our inventories stabilized in the quarter and we continue target a reduction in inventories during the year.

While maintaining a strong balance sheet, we have been returning a significant amount of capital to shareholders over the last year and continued to do so in the first quarter. During the first quarter, we repurchased shares for a total of $113 million completing our existing authorization. Today, we announced a new $200 million share repurchase program, another commitment in our efforts to enhance shareholder value by returning capital. IPG has returned a significant amount of capital since the beginning of 2022, repurchasing over $600 million in shares outstanding.

Moving to outlook on slide 9, first quarter book-to-bill was 1. We continue to see uncertain macroeconomic conditions and soft demand in general industrial markets. Despite relaxing Covid restrictions in China, demand remains relatively muted. However, we are still seeing solid activity and orders in e-mobility and renewable energy across all geographies. Despite all of the uncertainty, IPG continues to benefit from growth opportunities created by major macrotrends such as electric vehicle battery manufacturing and renewable energy. Furthermore, LightWELD has been gaining traction in the U.S., Europe and Asia. We believe these trends and continuing efforts to diversify our revenues will make IPG more resilient and drive our growth.

For the second quarter of 2023, IPG expects revenue of $325 million to $355 million. The Company expects the second quarter gross margin to be between 41.5% and 43.5%. IPG anticipates delivering earnings per diluted share in the range of $1.05 to $1.35, with approximately 47.5 million diluted common shares outstanding.

As discussed in the "Safe Harbor" passage of today's earnings press release, 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 "Safe Harbor" and the company's reports with the SEC.

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 will be participating in a number of investor events this quarter and are looking forward to speaking with you over the coming weeks. Have a great day everyone.