IPG Photonics Corporation
Second Quarter 2023 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' second 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 Senior Director, 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, August 1, 2023, only and 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 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. I am pleased with our performance this quarter. Second quarter revenue came in at the midpoint of our guidance range, despite increased macroeconomic uncertainty, which resulted in project delays and impacted sales and outlook in industrial markets across many geographies. We reported another quarter of solid revenue growth in welding and cleaning applications that were driven by strong sales in e-mobility and handheld welding solutions. Additionally, revenue improved in 3D printing and solar cell manufacturing applications as investments in these markets increased. Sales in flat sheet cutting applications declined year over year, mostly due to economic uncertainty and increased competition in China, and continued to negatively impact our results. However, cutting sales were up sequentially in China, North America and Japan.

Emerging growth product accounted for 41% of total sales in the second quarter. We saw continued growth in AMB lasers, LightWELD, green and ultrafast lasers as well as beam delivery, but sales declined in medical and advanced applications as well as in laser-based systems and high power pulsed lasers. We have shipped our first 50 kilowatt AMB laser during the quarter and continued to invest into international sales platforms for LightWELD. As we said on our first quarter conference call, our medical business was impacted by a large customer working through the inventory, which reduced sales in the second quarter. We expect medical sales to return to a more normal level in the third quarter and continue to focus on additional growth opportunities in the medical market.

Despite of challenging operating environment, the positive results were driven by our progress in diversifying revenue and reducing our exposure to low-margin and highly competitive business.

We have been focusing on products and applications which benefit from global investments in e-mobility and renewable energy and this strategy is yielding good results.

IPG had another quarter with strong sales in e-mobility applications, driven by an increase in sales to geographies outside China, primarily in North America, Europe and South Korea. EV-related investment in China slowed during the quarter, particularly into traditional prismatic cell batteries, but we are seeing increased investments into newer technologies such as large cylindrical cells and also more investments into batteries for storage applications. Our team is working on new business opportunity in foil cutting applications and electric motor assembly. With a continued adoption of the electric vehicles and growth in energy storage globally, demand for batteries should quickly catch up with recent capacity additions and we expect investment in battery manufacturing in China to be stronger next year. Meanwhile, we are seeing increased investment in EV battery capacity outside of China and expect e-mobility orders to remain strong in the third quarter.

Our welding sales are benefiting from growth in e-mobility applications where our complete solution, which includes AMB lasers and welding heads combined with our real-time weld monitoring and measuring technology, which has become the industrial standard. LDD's real-time measurement can significantly reduce testing times, scrap cost and failed parts for the customer, making a very strong value proposition and an exceptional return on investment given the yield and cost benefits. LDD is also getting great acceptance in applications outside of batteries, where the final cost of defect can be very high and lead to significant recalls.

We are proud to deliver multiple solutions which can significantly reduce the environmental impact for our customers, including our high-efficiency ECO lasers with the industry-leading wall-

plug efficiency of over 50%, environment-friendly cleaning solutions, and high-efficiency laser diode drying and heating systems.

During the quarter, we continued to see strong results in our laser cleaning solutions in e-mobility and other automotive and non-automotive applications. Laser cleaning provides sustainability benefits by reducing the use of abrasives, chemicals and dry ice cleaning. Unlike chemicals, abrasives and heat-treatment cleaning processes, laser cleaning does not impact the material that is being cleaned, does not leave toxic waste and also creates a safer and cleaner environment for employees. It can also significantly reduce water consumption. We are seeing increasing interest in our laser cleaning solutions for a number of different processes and applications, including paint and corrosion removal.

Another recently-introduced laser solution which is replacing less-efficient infrared bulbs for drying and heating, is gaining interest and we have booked our first order for EV battery applications, which will be shipped in the third quarter. The drying solutions are well-received by customers and are gaining market acceptance because they significantly cut down energy consumption and reduce the environmental impact of legacy processes.

Today, I am happy to announce that the Board of Directors has elected Kolleen Kennedy as a new director of the company. I am looking forward to working with Kolleen and believe she will be a great contributor to IPG's strategy, particularly with our growth in medical applications given her 25 years of experience in the medical system manufacturing industry.

I would like to thank our employees for their strong contribution in the quarter and will now turn the call over to Tim to discuss financial highlights.

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 second quarter was $340 million, a decline of 10% year over year, partially due to foreign currency headwinds, which accounted for approximately 2% of the decrease and the telecom divestiture that reduced revenue by approximately 1%. Revenue from materials processing applications decreased 8% year over year, while revenue from other applications decreased 23%.

GAAP gross margin was 43.4%, a decrease of 230 basis points year over year, due to higher cost of product sold and charges for scrap, which were partially offset by lower inventory reserves, reduced shipping costs and tariffs as well as an improvement in absorption of manufacturing costs as a percentage of sales. On a sequential basis, gross margin continued to improve as we focused on reducing costs and improving manufacturing efficiency. We also benefited from slightly lower inventory provisions and shipping costs.

As mentioned before, FX headwinds 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 $9 million higher and gross profit to be $5 million higher.

GAAP operating income was $72 million and operating margin was 21.2%. Net income was $62 million, or $1.31 per diluted share. The effective tax rate in the quarter was 24% and was benefited by certain discrete items.

Foreign currency transaction expense related to remeasuring foreign currency assets and liabilities to period-end exchange rates, had a negative impact on operating income of $1 million, but, net of a tax benefit had no material impact on earnings per share. Excluding the currency transaction loss and a restructuring charge, operating expenses declined year over year, primarily in research and development and general and administrative categories as we reduced spending on telecom product development, implemented tighter cost controls and reduced expenses.

Moving to slide 5. Sales of high power CW lasers decreased 10% and represented approximately 43% of total revenue. Sales of ultra-high power lasers above 6 kW represented 50% of total high power CW laser sales, with customers outside of China moving to higher powers. The decline in revenue was primarily due to lower demand in flat sheet cutting applications as a result of softer demand and competition in China. Pulsed lasers sales decreased 24% year over year as strong growth in cleaning and solar cell applications was offset by lower demand in foil cutting and marking applications. Systems sales declined 1% year over year with growth in LightWELD offset by a decline in other laser and non-laser systems. Medium power laser sales increased 18% driven by increased demand in welding and 3D printing applications while QCW laser sales were down 2% year over year. Other product sales decreased due to lower revenue in medical and advanced applications.

Looking at our performance by region on slide 6, revenue in North America decreased by 11% with strong growth in welding and cleaning applications offset by lower sales in advanced and medical applications, lower cutting revenue and the divestiture of the telecom business.

In Europe, sales increased 4% driven by growth in welding and cleaning applications, despite overall uncertainty in the economy. At the recent laser show in Europe, the tone about business was muted with most customers expecting a slowdown in the second half of 2023.

Revenue in China decreased 28% year over year as demand declined across most markets and applications compared to the prior year with the exception of cleaning and 3D printing.

Moving to a summary of our balance sheet and cash flow on slide 7, we ended the quarter with cash, cash equivalents, and short-term investments of $1.1 billion and repaid $16 million of debt in the quarter. Cash provided by operations was $67 million and capital expenditures were $26 million during the second quarter. We now expect capital expenditures to be between $130 million and $140 million this year. Our inventories decreased slightly and we continue to target further reductions in inventories during the second half of the year.

While maintaining a strong balance sheet, we have been returning a significant amount of capital to shareholders over the last year and in the first quarter. We did not repurchase shares in the second quarter. As previously reported, the Board announced a new $200 million share repurchase authorization in May and we have a new 10b-18 repurchase plan in place. We intend to repurchase shares opportunistically.

Moving to our outlook on slide 9, second quarter book-to-bill was below 1. We continue to see uncertain macroeconomic conditions and soft orders in all major manufacturing regions. Leading indicators in North America and Europe point to contraction in the industrial markets while the timing of demand recovery in China remains uncertain. However, despite the weaker business conditions overall, the e-mobility sector was not affected in Europe and North America and we are still seeing solid activity and orders in e-mobility for the third quarter. Furthermore, we expect to see normalizing demand in medical and advanced applications as well as the systems business, which should help to offset increasing headwinds in the rest of the business.

For the third quarter of 2023, IPG expects revenue of $300 million to $330 million. The Company expects the third quarter gross margin to be between 40% and 42%. IPG anticipates delivering earnings per diluted share in the range of $0.85 to $1.15, 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.