IPG Photonics Corporation
Third Quarter 2023 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' third 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 with your conference.

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 on the SEC's website.

Any forward-looking statements made on this call are the company's expectations or predictions as of today, October 31, 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 also 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:

Good morning everyone. Our third quarter revenue was negatively impacted by softer demand in the industrial markets and further decline in sales in China. Lower demand from industrial customers and reduced demand in e-mobility applications drove revenue declines in cutting, welding and marking applications. We also continued to see strong competition in addition to soft demand in the flat sheet cutting market in China. But even with lower revenue, we are pleased with our operating performance this quarter and delivered gross margin improvement and earnings per share at the high end of our guidance.

While the uncertainty in macroeconomic conditions continued to weigh on capital equipment spending, customers in Europe, North America and Japan are increasingly using high-power lasers for cutting. We believe that laser adoption in these geographies is significantly behind China and these markets remain less competitive with IPG holding a strong market position. We are also seeing the adoption of laser welding technology in automotive and general industrial markets across many geographies. Laser welding provides high speed, precision and accuracy as well as low heat input and ability to join dissimilar materials. Our real-time weld measurement system is a great complementary technology to the adjustable mode beam (AMB) lasers and IPG welding heads that provides fast and reliable welding solutions for a broad range of applications across many different industries.

Emerging growth product sales accounted for 42% of total revenue in the third quarter. We saw a decline in AMB and high power pulsed lasers related to lower demand in e-mobility applications due to decreased investment in EV battery capacity in China. We said in the past that EV battery investment is likely to fluctuate quarter to quarter. Production expansion projects can be very large in size and provide some lumpiness to our e-mobility sales. As a result, some

quarters and even years may be better than others. However, we expect EV investment cycle to continue, providing great opportunity for IPG in the next 3 to 5 years. Adoption of electric vehicles still grows in China, Europe and North America and battery manufacturers will need to build additional capacity to support higher EV sales. Also, energy storage is growing and may potentially require even more batteries to support the transition to a sustainable energy future.

Our handheld welder sales continued to grow, driven by a rollout in Europe and LightWELD has up to 4 times the speed of a traditional MIG and TIG welder and does not require extensive training. We are seeing high interest in the welding community and held five simultaneous live demonstrations of the device at the Fabtech show this year to satisfy this interest. We are still early on the adoption curve and continue to promote LightWELD in the welding market in the U.S. and other geographies.

We are also seeing a significant increase in demand for our lasers in 3D printing applications. Industry reports suggest that the technology is being tested for manufacturing of consumer electronic devices. Growth in metal 3D printing technology has been slower than many had anticipated, but it seems like there is a new catalyst that can potentially drive further adoption. 3D printing is using high-quality lasers to melt metal powder to create parts and IPG has a strong position in this market, providing lasers with high stability beam characteristics. We recently introduced a new AM laser, designed specifically for additive manufacturing. This laser has an adjustable mode and can move from single-mode for fine structures to multi-mode output for up to 6 times higher build-up rates.

Finally, sales in our medical business improved as expected after the inventory reduction by a large customer in the prior quarter. Growth in medical continues to be driven by adoption of our laser system and consumable fibers, which are considered the gold standard in urology applications. We are also seeing strong growth in aesthetic applications, which is a much larger

market. Our fiber laser technology is significantly more advanced compared to traditional lasers used in medical and aesthetic applications; and our goal is to gain market share by replacing these older technologies. 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 summary, I remain optimistic about the growth drivers for our products and continued diversification of IPG revenue in the long term. We have introduced new products for laser cleaning and drying applications this year and promote our high-efficiency ECO lasers that help reduce the environmental impact for our customers. 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 third quarter was $301 million, a decline of 14% year over year. Foreign currency headwinds reduced revenue growth by approximately 2%. Revenue from materials processing applications decreased 15% year over year, while revenue from other applications was nearly flat.

GAAP gross margin was 44.1%, an increase of 100 basis points year over year, which was driven by lower inventory provisions and 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 on lower revenue as we focused on reducing costs, managing inventory and improving manufacturing efficiency.

Despite the headwinds to our revenue from a challenging operating environment and reduced capital equipment spending worldwide, I am pleased with the resilience of our financial model and the company's ability to improve margins and to continue to generate ample cash flow from operations to support current and future investments.

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 $6 million higher and gross profit to be $4 million higher.

GAAP operating income was $56 million and operating margin was 18.5%. Net income was $55 million, or $1.16 per diluted share. The effective tax rate in the quarter was 19% and benefited from certain discrete items.

Foreign currency transaction gains related to remeasuring foreign currency assets and liabilities to period-end exchange rates, had a small positive impact on operating income of $0.4 million, or $0.01 per share.

I would like to remind you that last year's results benefited from $22 million or $0.32 per diluted share gain on the sale of the telecom transmission business. Excluding the currency transaction gain, asset impairment and a recovery of a restructuring charge related to our Russian operations as well as the gain on sale of telecom business last year, operating expenses were nearly unchanged year over year. Sequentially, operating expenses increased primarily in research and development and sales and marketing as we invested in resources to drive future growth while still controlling expenses.

Moving to slide 5. Sales of high power CW lasers decreased 22% and represented approximately 40% of total revenue. Sales of ultra-high power lasers above 6 kW represented 46% of total high power CW laser sales. The decline in revenue was primarily due to lower demand in flat sheet cutting applications in China and Europe. We continued to see customers outside of China adopting laser technology, but demand has been impacted by the economic uncertainty with OEMs delaying purchasing and reducing inventories. Pulsed lasers sales decreased 25% year over year due to lower sales in marking and solar cell applications. Systems sales increased 4% year over year with growth in LightWELD offsetting a decline in non-laser systems. Medium power laser sales increased 1% driven by increased demand in welding and higher sales in 3D printing applications. QCW laser sales were down 4% year over

year. Other product sales decreased due to lower revenue in advanced and telecom applications.

Looking at our performance by region on slide 6, revenue in North America decreased 13%. We saw strong growth in welding and cleaning applications as well as higher parts and service sales. However, this growth was more than offset by lower sales in cutting, medical, advanced and telecom applications.

In Europe, sales increased 3% and the region continued to perform well given the weak macroeconomic environment. Revenue growth was driven by welding and semiconductor applications. Revenue declined in cutting, marking and cleaning applications, which were impacted by lower industrial demand and destocking by some OEM customers.

Revenue in China decreased 28% year over year as demand declined across most industrial applications, including cutting, welding and marking. Additionally, revenue was negatively impacted by competition in the flat sheet cutting market and lower demand in e-mobility applications due to a decline in new battery projects and delayed capacity expansions.

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 no debt. Our inventories continued to decrease sequentially and we target further reductions in inventories in the fourth quarter. Cash provided by operations was $86 million and capital expenditures were $26 million during the third quarter. We sold two buildings in the quarter, realizing $29 million in proceeds, which means net capital expenditures are just under $55 million year to date, well below the same period last year.

While maintaining a strong balance sheet, we have been returning a significant amount of capital to shareholders through opportunistic share repurchases. We spent $46 million on share repurchases in the third quarter and approximately $160 million this year.

Moving to our outlook on slide 9, third quarter book-to-bill was below 1 with macroeconomic uncertainty resulting in project delays and reduced orders in all major manufacturing regions. Leading manufacturing indicators in Europe are trending at the lowest levels since the 2008 recession. While economic indicators in China are mixed, we believe the Chinese cutting market is down 20% to 30% and the timing of an overall recovery in demand remains uncertain despite some government stimulus. Competition from Chinese manufacturers remains stiff. Additionally, project delays related to battery capacity expansion in China provide further uncertainty to the outlook. Although we have limited visibility into orders beyond the fourth quarter, we continue to believe that battery investment in China should restart in 2024 as electric vehicle sales continue to increase. Investment in battery capacity outside of China is in the early stages and should increase in the next several years as well. We also expect some benefits from government spending and onshoring activities to benefit industrial activity in the U.S.

For the fourth quarter of 2023, we expect revenue of $270 million to $300 million. The fourth quarter gross margin estimate is between 41% and 43%. We anticipate delivering earnings per diluted share in the range of $0.80 to $1.10, with approximately 47 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 again soon. Have a great day everyone.