IPG Photonics Corporation
First Quarter 2024 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' first quarter 2024 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, 2023 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, April 30, 2024, 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. In addition to our earnings release, we announced a leadership transition this morning. Let me start by commenting on the quarterly results first and then I will speak about the CEO change later in the call. In the first quarter, we continued to generate strong operating cash flow, reduced inventories, managed product costs and returned capital to shareholders. We achieved this while facing soft demand in general industrial manufacturing and e-mobility end markets, which together represented over 60% of our total sales and negatively impacted revenue across many applications. Our book- to-bill was above one and we believe that we are seeing a bottom in demand with a potential modest improvement toward the end of the year. At the same time, we remain focused on execution of our long-term strategy to displace other laser or non-laser tools with our fiber lasers and grow revenue in a number of focus applications such as welding, cleaning, heating and medical, diversifying away from more competitive applications such as cutting and marking. Revenue in our emerging growth products accounted for 45% of total sales in the first quarter. These laser products and solutions can provide significant improvements in speed and quality of manufacturing processes while reducing energy consumption and other environmental impacts.

I will cover highlights and comment on revenue by applications first and Tim will cover our financial results in more detail. Starting with our largest application, welding revenue declined year over year primarily due to lower demand from e-mobility customers. Significant reduction in new battery investments in China, compared to the prior year, and delayed EV battery projects in North America reduced demand for our welding products and solutions. At the same time, we believe we were able to gain some market share in EV welding, closing new business opportunities both with significant new customers and in new applications. Additionally, we are

working with a number of leading automotive manufacturers on new fiber laser applications in batteries and general automotive assembly. We remain optimistic that EV battery investments may increase again toward the end of 2024 into 2025, resuming a multi-year trend of building out required battery capacity to support the transition from internal combustion vehicles to battery electric cars or plug-in hybrids. Additionally, we were pleased to see a pick up in demand from consumer electronics battery applications as well as growth in welding revenue in general automotive and general industrial applications. Adoption of our real time welding monitoring system and complete automated welding solutions are also showing good results.

Our handheld welder sales slowed in North America in the quarter with some smaller customers being impacted by uncertainty in demand and higher financing costs, but order pipeline and customer interest remain strong. In addition, we are starting to ship these devices to Miller Electric, which will help handheld welder sales in the second quarter and will have a more measurable impact in the second half of the year.

Sale in cutting applications declined in the first quarter due to continued soft industrial demand across all major geographies. Large OEM customers were managing their inventories, which negatively impacted our cutting sales in Europe, North America and Japan. Market conditions remain difficult, but appear to be more stable compared to the last several quarters and we expect that improvements in general economic conditions and reduced customer inventories should result in more stable demand in the second half of the year. Foil cutting sales also remained soft due to weak demand in e-mobility, but our systems sales showed some improvement year over year.

In other materials processing applications, cleaning sales were negatively impacted by softer demand in e-mobility, but we are making progress introducing our cleaning solutions across

many general manufacturing applications. Cleaning revenue has been increasing and the application is becoming a meaningful contributor to total sales.

While still relatively small, heating and drying lasers is another area of future growth for IPG. The application delivered strong increase in sales this quarter as we shipped a large order for foil drying to an e-mobility customer. Additionally, we are working with a number of large manufacturers from across a number of application areas to build innovative heating and drying solutions to suit their needs. Finally, revenue increased in 3D printing applications as the industry is using a large number of high-quality lasers to melt metal powder to create parts. IPG has a strong position in this market, providing lasers with high stability beam characteristics.

Outside of materials processing, other applications revenue declined due to lower sales in medical and advanced applications. Our medical business was negatively impacted by a large customer managing inventories in the first quarter. We expect medical revenue to normalize in the second quarter and we are working on several new opportunities that will launch in 2025 and 2026 and should help this business to grow and become a more meaningful contributor to IPG's total sales.

Before I turn the call to Tim, I will provide a few comments on the leadership transition we announced this morning. I would like to welcome Mark Gitin as IPG’s next CEO. The Board performed an extensive search and selection process and chose Mark Gitin because he possesses a unique combination of relevant scientific expertise and a proven ability as a successful operator in our industry. I look forward to helping him to make the transition seamless for our customers, employees and other stakeholders.

I also would like to thank the IPG team for its contributions over the last 30 years. I was fortunate enough to be a part of the team that transformed the laser industry and helped IPG to become a global industry leader. I believe that the best opportunities are still ahead for IPG, and fiber

lasers will continue to displace other technologies, driving future growth for the company. I will miss my day-to-day interactions with my IPG colleagues, but I make this transition knowing that we have accomplished great things. This will be my last earnings call, but I will remain on the Board supporting the next leg of the journey for IPG and I will also be involved as an advisor to Mark and the Board. With that, I will now turn the call over to Tim to discuss financial results.

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 5.

Despite the headwinds to our revenue, I am pleased with the resilience of our financial model and the company's ability to generate strong cash flow from operations to support current and future investments as well as continued opportunistic share repurchases.

Revenue in the first quarter was $252 million, a decline of 27% year over year. Foreign currency headwinds reduced revenue growth by approximately 2%. Revenue from materials processing applications decreased 28% year over year, while revenue from other applications decreased 25%.

GAAP gross margin was 38.7%, a decrease of 360 basis points year over year due to lower absorption of manufacturing costs, as a result of lower revenue, and higher inventory provisions. These negative impacts were partially offset by improved product costs, mostly as a result of product mix, and lower shipping and tariff costs. On a sequential basis, gross margin improved, due to lower product cost, a decrease in expenses related to scrap and duty, which were partially offset by an increase in inventory provisions and unabsorbed manufacturing expenses expressed as a percent of revenue.

Operating expenses came in at the high end of our expectations and increased both year over year and sequentially, primarily in research and development and sales and marketing, as we invested in resources to drive future growth while still controlling general and administrative expenses.

FX headwinds also had a negative impact on revenue and gross profit 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 $8 million higher and gross profit to be $5 million higher.

GAAP operating income was $19 million and operating margin was 7.6%. Net income was $24 million, or $0.52 per diluted share. The effective tax rate in the quarter was 28%.
Foreign currency transaction losses related to remeasuring foreign currency assets and liabilities to period-end exchange rates, had a negative impact on operating income of $2 million, or $0.03 per share. We continued to optimize our footprint and, as a result, we sold two buildings during the quarter. The gain on sale of these assets increased operating income by $7 million and increased diluted EPS by $0.11.

Moving to revenue performance by region on slide 6. Sales in North America decreased 16%. We saw a decline in revenue in medical, welding, cleaning and advanced applications, partially offset by growth in cutting systems and increased revenue in parts and services. Uncertainty in the general demand environment and lower e-mobility sales as well as cutting OEMs and medical customers managing inventories were the main reasons behind the decline in North America.

In Europe, sales decreased 21% as growth in welding was more than offset by reduced sales in cutting applications due to large cutting OEM customers reducing purchases to manage inventories. Demand in 3D printing applications was also soft in the region. Economic conditions in Europe remain challenging, but we saw some improvements in e-mobility sales and benefited from a continued rollout of LightWELD in the region.

Revenue in China decreased 38% year over year as demand declined in general industrial and e-mobility markets, negatively impacting sales across cutting and welding applications. On the

other hand, sales to 3D printing applications increased in China as the industry is seeing growing investments in the region.

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 are targeting further reductions over the course of 2024. Cash provided by operations was $55 million and capital expenditures were $28 million during the first quarter. As I mentioned earlier, we sold two buildings in the quarter, realizing $25 million in proceeds, which means net capital expenditures were just under $3 million, 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 $90 million on share repurchases in the first quarter and continue to view current share prices attractive at current levels.

Moving to our outlook on slide 9, first quarter book-to-bill was slightly above 1. However, macroeconomic uncertainty is still negatively impacting demand across all of our major markets and resulting in project delays and reduced orders. Additionally, project delays related to battery capacity expansion are providing headwinds to our sales in China and North America. On a bright side, leading manufacturing indicators have been improving in U.S. and China and bottoming in Europe and Japan, which should lead to more stable demand for our customers. We also expect that medical and LightWELD will return to more normalized revenue levels in the second quarter.

For the second quarter of 2024, we expect revenue of $240 million to $270 million. The second quarter gross margin estimate is between 37% and 40%. We anticipate delivering earnings per diluted share in the range of $0.30 to $0.60, with approximately 46 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.

Before we move on to questions, I would like to express our gratitude to Dr. Scherbakov on behalf of the Board, management team and employees of IPG. He has made vast contributions over the past 30 years, too many to describe today. But we should recognize his contributions particularly during his time as CEO, including by strengthening IPG’s competitive position and laying the foundation for our next phase by establishing a clear strategic plan focused on key growth markets and applications, reorganizing R&D and disposing of non-core assets. We all look forward to continuing to work with Dr. Scherbakov in his capacity as a director.

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.