IPG Photonics Corporation
First Quarter 2021 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' first 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' Executive Chairman, Dr. Valentin Gapontsev, 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, May 4, 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 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 Valentin.

Valentin Gapontsev:

Good morning everyone. We made two announcements today. I will first discuss our results.

I am very pleased to report another quarter of solid performance and excellent execution with strong revenue and earnings. Our revenue increased significantly compared to the same period in the prior year, which was impacted by weak macroeconomic conditions and global lockdowns related to COVID-19 pandemic. Revenue was also higher sequentially, despite typical seasonality, as a result of continued positive performance in North America and a sequential improvement in sales in Europe. Our bookings remain at high level, particularly in China, and we expect growth will continue in the second quarter as we benefit from our technology leadership, leading-edge products and global footprint.

During the quarter, we demonstrated excellent progress in our core markets with strong growth in cutting, and even stronger growth in welding applications. Ultra-high power lasers made up 55% of total high power sales and increased 55% in the quarter. At the high end of the market, we are seeing an increased interest and order volumes for our 20 and 30 kilowatt ultra-high power lasers and optical heads that offer cutting speed improvement for materials up to 30 millimeters thick and are replacing plasma cutting machines, other non-laser processes and lower power laser solutions. Our lasers provide superior beam parameters, record wall-plug efficiency and high reliability that are the hallmarks of the IPG brand. They also drive a great return on investment for our customers.

Growth in welding applications stood out significantly this quarter. Sales of our high power CW and QCW lasers for welding applications nearly doubled compared with the same period last year. Sales of our adjustable mode beam (AMB) lasers increased and continue to gain share in the welding industry for general manufacturing purposes and in electric vehicle battery welding applications. Our AMB products offer superior speed and weld quality over competing solutions with a broad range of beam tunability, enabling spatterless welding, which is extremely important for battery manufacturing.

During the first quarter, emerging products grew by 62% and contributed 29% of total revenue as compared to 25% in Q1 2020. Emerging product growth was broad-based, but a highlight of this performance, was the substantial growth in green pulsed lasers. We doubled sales for green pulsed lasers for solar cell manufacturing and other applications, displacing competitors in some instances, and scaled up manufacturing to meet demand. Additionally, we are increasing the pulse energies of green lasers to enable next generation applications in solar, drilling and copper welding for consumer electronics. Other emerging products that performed well were high power pulsed, ultrafast pulsed, beam delivery and monitoring, and AMB.

Customer feedback on LightWELD, our handheld laser welder, is very positive. Customers are excited about the ease of use, improvements in weld quality, diversity of materials that can be joined, and programmed welding parameters for different types and thickness of materials. In certain applications, LightWELD enables customers to decrease material costs for manufactured parts because they can use metal that cannot be welded by legacy processes. LightWELD also cleans surfaces both before and after welding, further reducing costs and improving productivity. Additionally, our handheld laser helps address shortages and costs of qualified welders because the training process takes only a few hours and the device is easy to use even for nonprofessional welders.

Revenue from other applications decreased by 9% as higher revenue from advanced applications and telecom was more than offset by lower revenue in medical. While revenue in medical declined due to the timing of orders, we have a strong order backlog for our thulium laser systems and the installed base for our consumable fibers for urology applications continues to grow.

We continue to focus on product innovation and have many tens of new projects across a wide range of applications.   These include processing of glass, ceramics, composite materials, numerous crystals, circuit boards, OLED film, batteries and solar cells. Beyond materials processing applications, we are developing new soft tissue medical treatments, mid-infrared lasers for molecular-level resolution online spectroscopy, inspection, sensing and biomedical research applications and new high-speed transceivers for the telecom and datacom markets.

In addition to reporting our first quarter results, we announced a management transition this morning, which follows a well-planned succession strategy that we had in place for some time. I am happy to announce that Dr. Eugene Scherbakov, who I consider a co-founder of IPG, will succeed me as IPG’s Chief Executive Officer. Dr.Scherbakov is the world known scientist in the field of nonlinear and waveguide optics. For many years, he worked at General Physics Institute of Russian Academy of Science under patronage of Nobel Prize winner, Alexander Prokhorov, before he joined me at IPG Laser, Germany in 1995. Many years he managed the best branch of IPG Corporation, sharing the position with Corporate Chief Operation Officer duties during the last two years.

I will transition into my new role of Executive Chairman of the Board and will continue to direct the research and development function and be involved in strategy. In my new role, I will be spending more time on innovation and our technical capabilities, which are my passions, to continue to promote development in lasers, components and applications that will drive future success and technology leadership for IPG. It is an exciting evolution for me and a very good transition for the Company.

With that, I'll turn the call over to Eugene, IPG’s new CEO.

Eugene Scherbakov:

Thank you Valentin, and good morning everyone. I feel extremely privileged to become the next CEO of this great Company and look forward to continuing the strategy of Dr. Gapontsev and deliver on our mission to make fiber laser technology the tool of choice in high-tech mass production.

Going back to our quarterly results, I will provide additional details on our operations and performance by region and I am happy to report that all four of our major production facilities are operating normally. IPG has adapted well to the new operating environment and is running production at high levels to support increased demand for our products. Travel restrictions and safety precautions limit customer visits, but we have seen an increase in traffic through our applications labs.

We are benefiting from a number of significant environmental trends that include increased investment in capacity for renewable energy and electric vehicles to support growth in sales. We are seeing increasing demand for our green pulsed lasers, which are enabling significant improvements in solar cell efficiency. We also supply a wide range of products that provide improvements to electric vehicle battery manufacturing process, including speed of manufacturing, high process reliability and design flexibility that all lead to increased battery performance and safety while lowering production costs. We expect to benefit from growth in electric vehicles sales driven by higher emission standards and government policies, primarily in Europe and China, that would require additional investments in battery manufacturing.

Our revenue in China increased 104% year over year in the first quarter, representing approximately 41% of total sales. We are seeing high demand for our ultra-high power lasers and laser heads from general manufacturing in China, driven by these lasers' thin metal processing productivity and ability to cut thicker metals. First quarter bookings in China were strong, benefiting from domestic infrastructure investments, EV and general manufacturing. As a result, our outlook for the second quarter is robust as we expect these demand trends to continue. Sales to the rest of Asia increased 45% year over year. We are seeing strong demand for our welding and foil cutting solutions from electric vehicles batteries manufacturing, growth in solar manufacturing and increased demand for our ultrafast lasers across all Asia. While sales in Japan decreased 21% year over year, macroeconomic indicators seem to be improving moderately and we are hopeful that the level of business activity will increase from the current depressed level.

In Europe, revenue increased 14% year over year as we saw an acceleration of demand from customers in the region, driven by growth in Germany. While COVID infection rates remain high in Europe, it appears that industrial growth is improving and bookings are incrementally positive, pointing to a continued recovery in the region.

First quarter revenue in North America continued to improve, increasing 9% year over year. Growth was primarily driven by automotive with investments in new battery capacity for electric vehicles being particularly strong. In addition to demand from EV battery manufacturers, there continue to be opportunities to replace old lasers at several auto manufacturers in the U.S.

Laser systems sales recovered from the low levels in the prior year although non-laser systems sales remained weak. The pipeline of opportunities for laser and non-laser systems has improved and we expect bookings to recover during 2021. As Valentin mentioned, medical revenue was lower, although increased medical bookings mean that medical revenue will also improve during the year. We are particularly pleased with the growth in sales of medical consumable fibers as the number of procedures performed with our gold standard lithotripsy system increases along with a growing installed base.

We continue to benefit from our vertically integrated production model which enables key technological advantages over the competition while minimizing costs and supply chain disruptions. Gross margin improved to 47.5% this quarter as we benefited from increased volumes and our continued focus on cost reduction initiatives. Total SG&A and R&D expenses increased by approximately $5 million year over year to $82 million in the first quarter, but declined as a percentage of revenue. We continue to believe that our large and diverse advanced materials and components technology platform, our efficient R&D model and our strong balance sheet and free cash flow provide us ample flexibility to respond to business disruptions and emerge from this pandemic a stronger company.

On behalf of Valentin and myself, I want to thank our employees for their execution during the first quarter. The health, safety and well-being of our employees, their families, our customers, our partners and our communities remains our highest priority.

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

Tim Mammen:

Thank you Eugene, and good morning everyone.

Revenue in the first quarter was $346 million, which increased 39% year over year and 3% sequentially. Revenue from materials processing applications increased 45% year over year and revenue from other applications decreased 9%. Sales of high power CW lasers increased 43% year over year and represented approximately 49% of total revenue. Sales of ultra-high power lasers at 6 kilowatt or greater represented 55% of total high power CW laser sales and increased 55% compared to the prior year. Medium power laser sales increased 41% on growth in cutting, welding and sintering applications. QCW laser sales increased 38% year over year on increased demand from welding applications. Pulsed lasers sales increased 74% year over year, with strong growth in green pulsed lasers used in solar cell manufacturing as well as higher sales of our high power and ultrafast pulsed lasers. Systems sales increased 46% year over year as lower Genesis revenue was offset by higher sales of other IPG laser systems. Other product sales decreased 6% year over year driven by lower medical laser sales.

First quarter GAAP gross margin was 47.5%, an increase of 620 basis points year over year. Compared with the year-ago period, the increase in gross margin was driven primarily by improved absorption of manufacturing expenses, a decrease in cost of product, inventory provisions and shipping costs as a percent of sales, partially offset by lower pricing.

GAAP operating income was $89 million and operating margin was 25.7%. First quarter net income was $68 million, or $1.26 per diluted share. The effective tax rate in the quarter was 23%.

During the quarter we recognized a foreign exchange gain of $7 million primarily related to appreciation of the U.S. Dollar versus the Euro. The foreign exchange gain benefitted EPS by $0.09.

If exchange rates relative to the U.S. Dollar had been the same as one year ago, we would have expected revenue to be $17 million lower and gross profit to be $10 million lower.

We ended the quarter with cash, cash equivalents, and short-term investments of $1.4 billion and total debt of $37 million. Strong operational execution resulted in cash provided by operations of $88 million during the quarter. Capital expenditures were $27 million in the first quarter and we expect capital expenditures will be in the range of $150 million to $160 million for the full year. During the quarter we repurchased 15 thousand shares for $3 million.

Commenting on outlook for the next quarter, we expect a strong quarter for revenue as regional and global economic indicators remain positive with continued improvement in manufacturing PMI in the U.S. and Europe, but with some moderation in the economic indicators in China.   As mentioned previously, first quarter book-to-bill was meaningfully above one and order backlog has increased since the beginning of the year. Displacement of non-laser technologies, secular environmental trends and investments we have made in emerging products, mean that we continue to see growth opportunities in ultra-high power cutting, electric vehicle battery production, solar cell manufacturing, medical procedures and advanced applications.

For the second quarter of 2021, IPG expects revenue of $360 to $390 million. Given the increase in sales we are returning to a more normal level of activity with moderately higher compensation and other operating expenses, which means that we expect total operating expenses to be in the range of $82 and $84 million. The Company expects second quarter tax rate to be approximately 25%, excluding any discrete items. IPG anticipates delivering earnings per diluted share in the range of $1.20 to $1.50, with 53.5 million basic common shares outstanding and 54.2 million diluted common shares outstanding.

There are several risks to our outlook as recent growth in China tempers, and from uncertainty regarding the rollouts and timing of vaccines in Europe, Japan and elsewhere, the resumption of normal business and travel activities, the impact of automotive plant disruptions from chip shortages, the resumption of spending in aerospace and stimulus efforts in the US and China. 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, public health requirements and government mandates.

As discussed in the "Safe Harbor" passage of today's earnings press release, actual results may differ from our guidance due to factors including, but not limited to, goodwill and other impairment charges, product demand, order cancellations and delays, competition, tariffs, trade policies, health epidemics and general economic conditions. 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 company's reports with the SEC.

With that, Valentin, Eugene and I 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.