

IPG Photonics Corporation

Fourth Quarter 2021 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' fourth 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' CEO, 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, February 15, 2022, 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 fourth quarter performance. We delivered revenue that was 8% higher than a year ago and above the top end of our guidance range. Our full-year revenue was a record, slightly above our prior record revenue reported in 2018. These strong results were driven by solid demand for our lasers in Europe, North America and improved demand in Japan, which more than offset soft demand in high power cutting applications in China. We saw increased sales in welding, high power cutting outside of China, marking, 3D printing, foil cutting, cleaning, semiconductor and a number of other products and applications that all contributed to our growth this quarter. Overall, sales outside of China grew to 69% of our total revenue, a level we have not seen in many years, showing our progress in achieving a better geographic balance in our business.

Sales of high power lasers benefited from an increase in order volumes in cutting application in Europe, North America and Japan as well as strong welding revenue, which was offset by lower demand in China high power cutting market. This was due to general market softness and increased competition in the low-cost portion of this market. We continue to successfully protect our market share in the areas which focus on reliability, technology and service. Our high power lasers and optical heads can deliver significant productivity improvements, electrical efficiency, flexibility and ease of use and integration as well as lowest total cost of ownership and global support, unmatched by other lasers and non-laser tools. At the same time, we are introducing ultra-compact rack mounted U series lasers with powers of up to 6kW, to be more competitive in low-cost cutting systems. We were also pleased with the growth we are seeing in medium power, pulsed and QCW lasers this quarter, which are primarily driven by higher demand in emerging applications.

I would like to also highlight our exceptional growth in welding this year, driven by higher

demand for AMB lasers used in EV battery manufacturing and the introduction of LightWELD, our handheld welder.

Both products are examples of IPG's focus on innovation and ability to deliver solutions to our customers that expand our total available market. Our AMB lasers provide a broad range of beam tune-ability that enables superior speed, better weld quality, ability to weld disparate materials and spatterless welding, which is extremely important in the EV battery manufacturing process. Another driver behind the strong welding results is LightWELD. Compared to traditional MIG and TIG welding, LightWELD is easier to use, faster, more precise, welds a wide range of materials better, and incorporates surface cleaning capability. These qualities significantly reduce preparation, processing and post-processing times, resulting in lower total operating costs for our customers. Growth in welding is one of many examples of successful revenue diversification strategy that IPG has been pursuing.

We are also pleased with the performance of our medical business, which delivered record revenue this quarter as our gold standard urology lasers and disposable fibers continue to gain acceptance.

Additionally, IPG is well positioned to benefit from global macro trends such as automation, miniaturization as well as focus on sustainability, renewable energy and energy efficiency. As you read and heard, automakers and suppliers worldwide are investing enormous amounts in new e-mobility products. We expect these investments to continue in the next 3 to 5 years or even longer. Our lasers are widely used in manufacturing of electric vehicles. We are supplying laser solutions for battery welding and thin foil cutting application, cleaning and hairpin welding in an electric battery and motor assembly as well as some body-in-white applications. Demand in the solar cell market can be cyclical, but strict emission targets are expected to drive significant investments in solar cell production in North America and China in the next 3 to 5 years, resulting in higher demand for green lasers. These lasers are used to improve solar cell

efficiency and reduce the amount of wiring needed in the solar cell design. Demand for our green lasers increased by 50% in 2021.

Focus on sustainability and efficiency as well as some recent energy shortages in China and high energy costs in Europe are driving an increased interest in our ECO lasers that provide wall-plug efficiency of greater than 50% and can help to meaningfully reduce the environmental impact and energy costs for medium and large industrial manufacturers.

During the fourth quarter, emerging growth product sales were 38% of total revenue, increasing 57% year over year. We were pleased with the performance of a number of products that are key to the diversification of our revenue, including AMB, high power pulsed lasers, LightWELD, medical, beam delivery, laser-based systems and multichannel QCW lasers for high-speed spot welding applications. Backlog for these products remains strong as we enter 2022 and we focus on successfully establishing large markets with our innovative solutions.

Let me share some of our expectations for 2022. While we continue to have limited visibility and see uncertainty in the operating and geopolitical environment, we believe that the breadth and depth of our product offering, our innovative solutions, efficient R&D model, strong balance sheet and free cash flow provide us ample flexibility to respond to business disruptions and support growth. We expect continued strong demand in welding and cutting markets in North America, Europe and Japan. Sales in emerging growth products should benefit from continued macro trends such as investments into EV batteries, solar cells, automation and miniaturization. However, this will be a transition year for IPG with growth in focus areas and continued diversification away from highly competitive portion of the high power cutting market in China leading to a more moderate 3% to 6% revenue growth in 2022. With that said, we remain optimistic in our long-term growth opportunities for IPG and continue to expect double-digit revenue growth in the mid to long term.

I'll 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 fourth quarter was \$364 million, up 8% year over year driven by growth in most of our key product lines and geographies, but declined 4% sequentially mainly due to lower revenue in high power cutting applications in China. Revenue from materials processing applications increased 5% year over year and revenue from other applications increased 41%.

Fourth quarter GAAP gross margin was 45.5%, an increase of 190 basis points year over year, driven by lower inventory provisions which reduced gross margin last year, but was partially offset by increased shipping costs and lower fixed cost absorption. Sequentially, gross margin decreased due to slightly higher cost of product sold, inventory provisions, shipping costs and unabsorbed manufacturing expenses. In order to offset some of the inflationary pressures we are experiencing we have increased the selling price of some products.

GAAP operating income was \$85 million and operating margin was 23.3%. Net income was \$65 million, or \$1.21 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 the appreciation of the US Dollar versus Euro and Russian Ruble and appreciation of Chinese Yuan.

If exchange rates relative to the US Dollar had been the same as one year ago, we would have expected revenue to be \$3 million higher and gross profit to be \$1 million higher.

Moving to slide 5. Sales of high power CW lasers decreased 19% and represented approximately 41% of total revenue. Sales of ultra-high power lasers above 6 kW represented

51% of total high power CW laser sales. Pulsed lasers sales increased 32% year over year, with continued growth driven by high power pulsed lasers used in EV battery manufacturing, which were partially offset by lower sales of green pulsed lasers used in solar cell applications.

Systems sales increased 28% year over year driven by growth across laser systems and higher sales of LightWELD. Medium power laser sales increased 28% on growth in 3D manufacturing and semiconductor applications. QCW laser sales were up 30% year over year due to higher demand in welding. Other product sales increased 81% year over year driven by higher sales in medical, telecom, advanced applications as well as beam delivery and parts.

Looking at our performance by region on slide 6, revenue in North America increased 30% driven by growth in material processing with strong cutting and welding revenue driven by higher demand in electric vehicles and traditional automotive industry. We also saw record revenue in medical applications and improved sales in telecom.

In Europe, revenue increased 37%, as a result of higher demand across many products and applications including cutting, welding, marking and semiconductor. The region is becoming a close number two in terms of revenue contribution for IPG.

Revenue in China decreased 20% year over year as we continued to see lower sales in high power cutting applications, which was only partially offset by growth in welding, high power pulsed cutting, 3D manufacturing, marking and cleaning applications. We are seeing order activity stabilizing in cutting, but portions of the cutting market that focus on price remain highly competitive.

We were pleased to see a solid improvement in demand in Japan this quarter, driven by higher demand in cutting and welding 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 \$1.5 billion and total debt of \$34 million. Strong operational execution resulted in cash provided by operations of \$85 million during the quarter. Capital expenditures were \$29 million in the fourth quarter. We expect 2022 capital expenditures will be in the range of \$130 million to \$140 million for the full year. 2022 capex includes facilities and capacity expenditure to support our future growth as well as redundant capacity for critical components. During the quarter, we repurchased 345 thousand shares for a total of \$57 million and have approximately \$80 million left under the May 2020 authorization. Last week, the Board authorized an additional \$200 million in share repurchases. Including this new program, the Board has authorized more than half a billion dollars in stock repurchases over the last three years.

Moving to outlook on slide 9, fourth quarter book-to-bill was close to 1, and we were pleased with order flow across most geographies and products outside of China. Macroeconomic indicators have been moderating, but remain strong for the U.S. and Europe while Japan continues to recover and China has indicated it will focus on stimulating economic growth in 2022. We are also seeing China high power cutting demand start to stabilize, albeit at lower levels. We continue to benefit from growth opportunities in electric vehicle battery manufacturing, roll-out of LightWELD and growth in medical sales. That said, there is still great uncertainty in the operating environment and price competition in China that make forecasting our business challenging in the medium term and our first quarter guidance remains subject to significant uncertainties, including the impact on the global business environment from geopolitical events, COVID-19, economic trends, growth from emerging product revenue, competition and the lack of long-term binding order commitments.

We are closely monitoring the situation between Russia and the Ukraine. As we have disclosed before, we supply components between our major manufacturing operations in the US, Germany and Russia. At this time, it is unclear if sanctions would be put in place and, should they be, if they would cover components bought from or sold to our Russian subsidiary. Sanctions could also target Russian banks and the banking system. In response to this uncertainty, we are developing contingency plans to mitigate possible disruptions, including increasing local inventory levels of key imported components and increasing production at other locations.

For the first quarter of 2022, IPG expects revenue of \$320 to \$350 million. The Company expects the first quarter tax rate to be approximately 26%. An increase in tax rate assumption is due to a decrease in the benefit expected from discrete items such as the excess tax benefit related to equity compensation. IPG anticipates delivering earnings per diluted share in the range of \$0.85 to \$1.15, with 54 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 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.