

IPG Photonics Corporation
First Quarter 2022 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' first quarter 2022 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 are detailed in IPG Photonics' Form 10-K for the period ended December 31, 2021 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 3, 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 to report a strong start to the year with the first quarter revenue above the top end of our guidance. Revenue increased 7% year over year, benefiting from higher demand in Europe, North America and Japan. We are particularly pleased to see that growth was driven by many emerging applications across all major geographies. As we stand back, we can identify several macro trends, such as automation and miniaturization as well as focus on sustainability, renewable energy and energy efficiency, including EV, which are driving this increased demand.

In the first quarter, we saw strong sales in welding, marking, systems, cleaning, 3D printing, semiconductor and medical applications. Sales outside of China grew to 65% of our total revenue, showing our progress in achieving a better geographic balance in our business. Our welding revenue was a record in the quarter and has become almost as important as our revenue from high power cutting applications in some regions or even outgrowing it as we saw in China. This was driven primarily by opportunities in electric vehicle batteries and automotive production that we are pursuing, as well as increasing demand for laser welding in general manufacturing, medical device applications and the adoption of our handheld laser for manual welding applications. Laser enables faster, more precise welding for a wide range of materials, including thin foils and highly reflective materials like copper and aluminum, that are difficult or impossible to weld with traditional MIG and TIG welding.

The strong growth in welding, foil cutting, marking and 3D printing applications nearly offset the expected drop in high power cutting applications in China, which stabilized at a lower level. As a result, high power cutting applications accounted for a much smaller portion of our revenues in China compared to a year ago. There is a different dynamic in the same application elsewhere. In Europe and North America, we see increasing adoption of lasers in cutting applications as

global manufacturers redirect investments to local supply chains and increase adoption of automation in manufacturing processes. Markets and applications that value our commitment to quality, innovative technology, reliability and global customer support are now IPG's focus.

We are pleased with the growth that we are seeing in medium power and pulsed lasers, which are primarily driven by higher demand in emerging applications. These lasers are used in foil cutting, 3D printing, solar cell manufacturing, manufacturing of electronics and semiconductor applications. These applications require high beam quality and stability as well as reliable lasers, characteristics for which IPG's devices are known by customers.

In the first quarter, emerging growth product sales were 36% of our total revenue. Many of these products are benefiting from global macro trends such as automation, miniaturization as well as focus on sustainability, renewable energy and energy efficiency. Our lasers are widely used in manufacturing of electric vehicles. We are seeing increasing investments by automakers and suppliers in e-mobility worldwide and continue to see strong growth in demand for our high power pulsed lasers, adjustable mode beam lasers and real-time welding monitoring capabilities that together can provide a highly customized and engineered solution to address many challenges in this complex manufacturing process. We expect the investments in e-mobility to continue.

Additionally, manufacturers are increasing spending on automation to address shortages of labor and wage inflation. Lasers can provide great productivity improvements and a significant return on investment. We are seeing increasing demand for LightWELD because it is easy to use and only requires hours of training for an inexperienced welder. This compares to months of training for a typical MIG and TIG welder. We have launched a third generation of the device, including an extended range of welding and cleaning capabilities for more diverse materials.

The focus on sustainability and energy efficiency plays well into laser cleaning applications that can reduce use of toxic materials. At the same time, high energy costs are driving demand and

increased interest in our premium ECO lasers that provide wall-plug efficiency of greater than 50% and can meaningfully reduce energy consumption in high power applications.

Before I turn the call to Tim, let me provide an update on impacts from the conflict in Ukraine which we all hope will come to a peaceful resolution soon. To help with the humanitarian crisis, IPG allocated half a million dollars to provide financial aid to our employees who help refugees from Ukraine. We are proud to hear that many of our employees have opened their homes to the refugees and provided clothes, food and temporary housing.

In response to the current situation, IPG stopped all new investments in Russia and already terminated some existing projects. As we announced on March 3, we are executing on our contingency plans, increasing manufacturing and inventories of critical components in United States and Western Europe. In the first quarter, we started hiring additional employees, allocating workspace for increased production and running second shifts in the U.S., Germany and Italy. We have also been qualifying third-party suppliers for certain components. These activities, which will accelerate during the second and third quarter this year, would significantly reduce IPG's reliance on Russian components by year-end. We are using this situation as an opportunity to introduce new production technologies and automation to increase yields and productivity. We recognize the risks of operating in the region as an escalation of sanctions would potentially have a significant impact on our business because the large capacity for critical components that many of our lasers rely on is currently in Russia. As we are making these decisions, we are doing our best to protect the interest of our employees and their families. 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 first quarter was \$370 million, up 7% year over year driven by growth in most of our key product lines and geographies, and increased 2% sequentially mainly due to higher revenue in China. Revenue from materials processing applications increased 7% year over year and revenue from other applications increased 9%.

First quarter GAAP gross margin was 46.4%, a decrease of 110 basis points year over year, due to increased shipping charges, higher cost of product sold and higher inventory reserves, partially offset by reduced manufacturing expenses as a percent of sales.

Excluding foreign currency gains, operating expenses increased slightly year over year, primarily in sales and marketing, to support higher revenues.

GAAP operating income was \$93 million and operating margin was 25.2%. Net income was \$70 million, or \$1.31 per diluted share. The effective tax rate in the quarter was 25%.

During the quarter we recognized a foreign exchange gain of \$6 million primarily related to the balance sheet impact as a result of depreciation of the Russian Ruble and the Euro as compared to the U.S. Dollar.

If exchange rates relative to the US Dollar had been the same as one year ago, we would have expected revenue to be \$10 million higher and gross profit to be \$4 million higher.

Moving to slide 5. Sales of high power CW lasers decreased 2% and represented approximately 45% of total revenue. Sales of ultra-high power lasers above 6 kW represented 49% of total

high power CW laser sales. Pulsed lasers sales increased 21% year over year, with continued growth in high power pulsed lasers used in EV battery manufacturing and increased demand in cleaning applications. Systems sales increased 28% year over year driven by growth in laser systems and higher sales of LightWELD. Medium power laser sales increased 49% on growth in welding, 3D printing, electronics and semiconductor applications. QCW laser sales were down 6% year over year. Other product sales increased slightly year over year driven by higher sales in medical, which were offset by lower sales in telecom and advanced applications.

Looking at our performance by region on slide 6, revenue in North America increased 5% driven by growth in cutting and welding revenue as well as increased revenue in medical applications and systems.

We saw strong revenue in Europe this quarter. Sales increased 27% in the region as a result of higher demand across many different applications including cutting, welding, cleaning, solar cell manufacturing and advanced applications. We believe that about 10 percentage points of this growth was attributed to pull forward of demand from the second quarter as customers were securing supply.

Revenue in China decreased 7% year over year. As expected, revenue in high power cutting applications stabilized at a lower level, but we saw strong growth in welding, foil cutting, marking and 3D printing in China.

Other Asia benefited from increased sales in cutting applications in Japan and good growth in Korea this quarter.

Moving to a summary of our balance sheet on slide 7, we ended the quarter with cash, cash equivalents, and short-term investments of \$1.4 billion and total debt of \$33 million. Cash provided by operations was \$16 million during the quarter and capital expenditures were \$25

million in the first quarter. Cash generation was negatively impacted by a further increase in strategic inventory during the quarter to offset ongoing supply chain constraints for electronic components and to build inventories of critical optical components outside of Russia. 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 additional capacity for critical components in Europe and the U.S. Capex previously budgeted to be spent in Russia will now be spent on investments to de-risk our internal supply chain. During the quarter, we repurchased over 600 thousand shares for a total of \$79 million, a record quarterly share repurchase number for the company. Since the end of the quarter we have repurchased additional 675,000 shares for \$66 million.

Moving to outlook on slide 9, first quarter book-to-bill was above 1, and we were pleased with order flow across all regions, which was in part driven by customers placing orders with requested delivery dates that extend beyond the second quarter. While our ability to ship products was not impacted in the first quarter, there are ongoing supply chain constraints worldwide that may impact us or our customers. In China, COVID-19 outbreaks and restrictions to control the spread of COVID-19 have resulted in a weaker economic outlook. There are also trade restrictions and economic sanctions on Russia in general that impact our operations there. The risk of a full Western embargo on Russia, the probability of which we cannot assess, continues to represent a material downside risk to the financial results and operations of the Company until new capacity for critical components is built in Europe and the U.S. While we are managing through the current situation, we expect higher import duties and tariffs on Russian sourced components as well as ongoing elevated shipping costs to negatively affect our margins.

Looking at the global demand environment, macroeconomic indicators have been moderating globally and despite strong indicators from the U.S. and Europe, we saw that March PMI in China indicated contraction. That makes forecasting our business challenging in the medium term and our second quarter guidance remains subject to significant uncertainties, including the impact on the global business environment from geopolitical events, trade restrictions and sanctions, COVID-19, economic trends, growth from emerging product revenue, competition and the lack of long-term binding order commitments. With that said, we feel optimistic as we continue to benefit from growth opportunities created by major macro trends such as automation, miniaturization and sustainability that drives growth from electric vehicle battery manufacturing, LightWELD and medical sales.

For the second quarter of 2022, IPG expects revenue of \$355 to \$385 million. The Company expects the second quarter tax rate to be approximately 26%. IPG anticipates delivering earnings per diluted share in the range of \$0.95 to \$1.25, with 53 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.