IPG Photonics Corporation
Fourth Quarter 2023 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' fourth 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, Senior Director of Investor Relations, for introductions. Please go ahead.

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 our 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, February 13, 2024, 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 website following the completion of this call. With that, I'll now turn the call over to Eugene Scherbakov.

Eugene Scherbakov:

Good morning everyone and thank you for joining us today. We are pleased to report that the fourth quarter revenue came in at the top of our guidance. We saw growth in multiple areas, including welding, cleaning, 3D printing and medical applications, that showed success in our strategy to diversify revenue away from cutting and reduce the amount of sales from China. We remained focused on our strategy to displace legacy technologies and processes with highly efficient and environmentally beneficial fiber lasers and laser-based technologies. Revenue in our emerging growth products improved sequentially and accounted for 46% of the total sales, driven by growth in handheld welding, beam delivery, and medical products. However, uncertainties in macroeconomic conditions continued to weigh on sales in many general industrial applications and some of our large OEM customers around the world were managing inventories and reduced purchasing in the quarter. Also, we saw soft demand for our lasers in e-mobility in China and solar cell manufacturing applications.

Welding sales rebounded strongly in the quarter with growth in North America more than offsetting lower revenue in China. Laser adoption is growing in general industrial and automotive applications, and not just in e-mobility. The increase in welding this quarter was driven by higher sales in our handheld laser welder, and growing adoption of our real-time weld measuring tool, which is becoming an industry standard for automated process monitoring and quality control. Customers understand a significant value proposition of real-time welding process monitoring, which can significantly reduce scrap and improve yields. We are also seeing higher sales of integrated laser welding systems, and complete solution for high-speed automated laser welding, which includes laser, scanner, vision and controllers that are easy to integrate in a manufacturing process.

I am happy to report another quarter of strong growth in the handheld laser welder. LightWELD sales benefited from a roll-out of the tool in Europe and increased 50% in 2023. We are expecting that the adoption will continue this year and are excited about our new partnership with Miller Electric to promote laser welding among a large network of MIG and TIG welders. Miller Electric is a leading worldwide manufacturer of arc welding products. We believe that most welding application can be addressed by laser, including the handheld market, and there is a tremendous productivity improvement that lasers enable. Welding is a large addressable market for our lasers and we are in the initial stages of developing it. Indicative of the success we are generating in welding, IPG's largest application increased 13% year over year and accounted for 36% of total annual revenue in 2023.

IPG remains well-positioned in e-mobility market, providing welding, cleaning, cutting and now drying solution to most major EV battery manufacturers around the globe. While our e-mobility sales were negatively impacted by a slowdown in new capacity additions in China, we saw an increase in sales in North America, Japan and Korea during the quarter. Overcapacity in battery production in China, after a strong investment cycle in 2021 and 2022, continued to provide a short-term drag on our growth, but we remain optimistic in the future revenues for this important application as new electric vehicle sales continue to grow worldwide. We are also looking to increase our exposure by adding more adjacent laser technologies around our current offering to further penetrate e-mobility applications. We successfully shipped the first orders of laser drying solutions for battery foil manufacturing. The solution replaces less efficient infrared bulbs and environmentally unfriendly gas-fired furnaces and can significantly increase drying speeds and reduce energy costs for our customers. For the full year, our EV sales increased modestly to a new record level and accounted for over 20% of total revenue.

Additionally, we are looking at new growth opportunities in the laser cleaning market. Laser cleaning solutions, while still small contributor to overall sales, have been growing at a high rate and there is an increased interest in the market to replace traditional cleaning process, which uses abrasive materials and chemicals. Whether it is paint or rust removal, our lasers can do the work quicker, more safely for the operator and with less harm to the environment.

Finally, our medical business delivered strong results in the fourth quarter. Full-year revenue grew slightly to a new record level despite some destocking by a large customer in the second quarter. We have benefited from growth in single-use fibers and some additional demand in aesthetic applications. We believe that there is a large installed base of old laser technology that can be replaced with fiber lasers over time.

As you can see from our guidance, which will be covered by Tim later in this call, we are looking at a slow start to the year as industrial demand remains weak. However, we are focusing on what we can control to offset these headwinds. We are targeting a number of large addressable markets where fiber lasers can replace existing laser and non-laser technology by taking advantage of several known trends, including automation, increasing efficiency and reducing environmental impacts. We expect these trends to continue and help diversify our revenue. We are also focused on operational improvements, such as lowering costs and reducing inventories in 2024. We are investing in the future growth and continue to maintain strong balance sheet. Our cash flow generation remains strong and benefited from inventory management. I would like to thank our employees for their contribution in 2023 and will 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 $299 million, down 10% year over year, but came in at the top of our guidance. Revenue from materials processing applications decreased 12% year over year due to lower general industrial demand which impacted revenue in cutting applications, partially offset by growth in welding, cleaning and 3D printing. Revenue in other applications increased 4% driven by the strength in medical.

GAAP gross margin was 38.2%, an increase from last year due to a significant decrease in inventory provision and other charges related to our Russian operations that impacted results in the fourth quarter of 2022. You can find details on these items in the financial tables of the press release. Additionally, gross margin benefited from lower shipping costs and tariffs, but these benefits were mostly offset by lower absorption of manufacturing costs and slightly higher cost of products sold. As we focused on reduction of inventory, we estimate that the impact of production shutdowns to work down our inventories reduced manufacturing cost absorption and reduced gross margin by approximately 4 percentage points in the fourth quarter as compared to the third quarter of 2023.

Additionally, both revenue and gross margin were negatively impacted by foreign currency translation. If exchange rates relative to the U.S. dollar had been the same as one year ago, we would have expected revenue to be $5 million higher and gross profit to be $4 million higher.

Operating expenses came in above our guidance range, driven by continued investments in R&D and sales organization to support our strategic initiatives and new applications. In 2023, we created numerous new and important sales roles globally that we expect will drive our sales and deepen customer relationships for the future. We also had higher stock-based compensation and some one-time expenses that increased operating costs in the quarter.

Foreign currency transaction loss related to remeasuring foreign currency assets and liabilities to period-end exchange rates, had a minor negative impact on operating expenses of $0.4 million or $0.01 per diluted share in the quarter. GAAP operating income was $29 million and operating margin was 9.6%. The net income in the quarter was $41 million, or $0.89 per diluted share.

The effective tax rate in the quarter was 2% and benefited from certain discrete items including closing tax audits.

Moving to slide 5. Sales of high power CW lasers decreased 19% due to lower sales in cutting applications in China and Europe as a result of lower industrial demand and OEM customers working down inventories, as well as increased competition from Chinese players in cutting applications. Sales of ultra-high power lasers above 6 kW represented 48% of total high power CW laser sales. Pulsed lasers sales decreased 40% year over year due to lower demand in solar cell manufacturing and battery foil cutting applications, driven by reduced industry demand. Systems sales decreased 1% year over year with strong growth in LightWELD offset by lower sales in other laser systems. Medium power laser sales increased 5% while QCW laser sales were up 6% year over year, driven by higher sales to consumer electronics, 3D printing and e-mobility applications. Other product sales were up meaningfully on strong growth in medical applications and beam delivery.

Looking at our performance by region on slide 6, revenue in North America decreased 3% due to lower demand in cutting applications, which was partially offset by higher sales in welding, mostly driven by strong revenue in e-mobility applications.

In the face of a wide-spread economic slowdown in Europe, sales increased 1% as the region continued to perform better than expected with higher sales across most applications, except for cutting.

Revenue in China decreased 25% year over year due to lower demand in general industrial markets, continued competitive pressure in cutting applications and reduced investments in electric vehicle battery production. China represented 24% of total sales in the quarter, its lowest level in the last 10 years.

Moving to a summary of our balance sheet on slide 7, we ended the quarter with cash, cash equivalents, and short-term investments of $1.2 billion and no debt. Cash flow generation remained strong with cash provided by operations of $106 million in the fourth quarter. Our capex was $25 million in the quarter and $110 million for the full year. Net of asset divestitures, capex was $79 million.

Our inventories declined in the quarter and decreased by more than 10% during 2023 as we continued to focus on managing inventory and reducing our investment in working capital. We will remain focused on lowering our inventories during 2024, which may have a short-term impact on margins, but will benefit our cash generation.

While maintaining a strong balance sheet, we continued returning capital to shareholders with our ongoing stock repurchases. We repurchased shares for a total of $64 million in the fourth quarter and $223 million in 2023. The Board has approved an additional $300 million in share repurchases. We have returned over $850 million to shareholders via share repurchases in the last three years and continue to buy back shares opportunistically.

Moving to outlook on slide 9, fourth quarter book-to-bill was below 1. Continued economic uncertainty with low PMI numbers in Europe, North America and Japan is impacting industrial demand and capital investments. We are also seeing our cutting OEM customers managing inventory and reducing purchasing, which may not restart until the second quarter. In China, demand has remained soft and some of the mature markets such as cutting and marking are facing severe competition. We expect e-mobility investments to pick up in China in 2024, but only in the second half of the year. While it will be a challenging start to the year, we believe demand will improve as the year unfolds. We continue to focus on emerging growth applications and our strategy to continue to drive laser adoption in new markets and applications in 2024.

For the first quarter of 2024, IPG expects revenue of $235 million to $265 million. IPG anticipates delivering earnings per diluted share in the range of $0.30 to $0.60, with approximately 46 million diluted common shares outstanding. The Company expects the first quarter tax rate to be approximately 25%.

We expect 2024 capex to be in the range of $120 million to $130 million, net of disposal of assets, as we continue to invest in additional manufacturing capacity in Germany, U.S. and other locations. Significant amounts of the spending in 2024 relates to replacement of fiber and other critical components capacity that we no longer have access to in Russia. We expect capital expenditures at a significantly lower level in 2025 and beyond.

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. As always, we will be participating in a number of investor events this quarter and are looking forward to speaking with you soon. Have a great day everyone.