IPG Photonics Corporation
Fourth Quarter 2024 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' fourth 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, and good morning everyone. With me today is IPG Photonics' CEO, Dr. Mark Gitin 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 directly.

Any forward-looking statements made on this call are the company's expectations or predictions as of today, February 11, 2025 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 after this call. With that, I'll now turn the call over to Mark.

Mark Gitin:

Thanks Eugene and good morning, everyone. For today's call, I'll provide a high-level overview of the quarter and share progress we've made on our strategy to drive long-term sustainable and profitable growth. After that, I will turn it over to Tim to provide more of the financial details, and then we will open the call for questions.

Starting with our fourth quarter, revenue came in at the high end of our guidance, up slightly from our third quarter and consistent with a business environment that continues to bounce along the bottom. Gross margin improved in the quarter helped by our efforts to reduce inventories. Our operating expenses were also better than expected and down both year over year and sequentially. Our progress on expenses reflects the hard work the team has already undertaken to reduce our cost structure and we will be deploying the savings towards strategic investments in the business. Our free cash flow remained strong, reflecting higher profits and the positive working capital impact, and we maintained a very strong balance sheet.

Although our results do not yet reflect our full potential, I'm proud of the progress we've made in navigating a challenging business environment that is impacting us on two levels: one, the tough macro conditions in general industrial and automotive markets, including EV; and two, a more competitive environment in cutting. Over the last few months, we undertook a comprehensive review of our strategy, markets, technologies, and competition. We then developed a plan to strengthen our current products, penetrate new applications and markets, introduce novel solutions, and set the foundation for a return to growth and better profitability in 2026 and 2027. Our leadership team and board are aligned around our strategic plan and we are hitting the ground running.

We are addressing the challenging near-term demand environment and increased competition by reducing product costs, accelerating product development and strengthening relationships and support for our OEM customers. A prime example of our efforts to reduce product cost is our recent introduction of a new high-power fiber laser platform. This platform features next-generation high-power pump diodes that enable a more compact design at a lower manufacturing cost to help our cutting OEM customers defend against low-cost Chinese-made systems. We also remain well-positioned for opportunities in applications such as welding and cleaning as industrial and e-mobility demand recovers.

In order to win in the long term, we are making investments in our business to drive differentiation in attractive markets where we can earn the greatest returns on our capital. Since I joined, we have taken a deep dive into every R&D program. Entering 2025, we are accelerating investment in several dedicated programs with strong market potential. Examples include urology applications, key micro-machining opportunities and other areas where we have strong expertise and important relationships with market-leading customers. In aggregate, these programs target markets exceeding $5 billion in TAM and offer IPG multiple hundreds of millions of dollars in revenue opportunities over the next several years. It's important to note that these roadmaps will develop over time and have multiple milestones to hit on the path to market, but we are engaged with key customers today and have booked initial orders for a number of products in development.

For competitive reasons we prefer to keep many of these initiatives out of the spotlight, but one area that I can highlight is urology. Urology is a multi-billion dollar TAM where we already have a solid position, and where our applications and laser expertise can be utilized to create novel treatment solutions and outperform what’s on the market today. We expect to introduce the next product on our urology roadmap later this year, our new generation of thulium laser systems for

the treatment of kidney stones, and we are making good progress in our other targeted R&D programs. We expect to generate initial revenue from some of these programs in 2025, with more meaningful returns on our investments beginning in 2026 and beyond as new products gain traction.

We are also actively seeking opportunities to expand product offerings and market reach in key application areas through targeted acquisitions. We are integrating our December acquisition of cleanLASER, a maker of laser-based cleaning systems. CleanLASER is an example of our plan to complement focused R&D with strategic tuck-in acquisitions that accelerate our penetration of important markets. By leveraging cleanLASER's unique technological expertise and European presence and combining it with our strength in other markets, we aim to accelerate growth of our laser-based cleaning systems. Cleaning is a promising market, particularly for laser systems for the long term and it's a market where we bring differentiated solutions.

Furthermore, to support our strategy, we are strengthening discipline and execution across the organization. We are increasing intimacy with our customers so that we can focus product development on their foremost needs. We are enhancing our go-to-market by optimizing our sales team structure to drive targeted business development opportunities and improve account and product management. And finally, we are enhancing our service strategy and our offerings to better support our customers, build trust and create recurring revenue opportunities.

In summary, from innovation and cost savings to strategic acquisitions and tailored solutions, our initiatives showcase the depth of work underway to strengthen IPG for the long term. While some of our initiatives, including our product development programs, will take time to be reflected in our results, our work today to strengthen our organization and execution will put us in

a position to mitigate the near-term environment, while positioning IPG for a stronger 2026 and beyond.

Moving to our near-term outlook, we continue to believe we are bouncing along the bottom, with fourth quarter book-to-bill close to 1. As I've discussed, we are investing in the growth of our business, which will have an impact on our profitability in the near term, but we are committed to these investments as they will drive shareholder value in the long term. When revenue growth returns, we expect to show strong operating leverage that highlights the value of our platform.

Before turning the call over to Tim, I wanted to touch on a few other items. The first is how we are thinking about capital allocation as we invest for the future. IPG has exciting opportunities ahead. We also have one of the strongest balance sheets in the industry, with over $900 million of cash and no debt. This financial strength provides flexibility and a significant competitive advantage. We've talked today about our strategic investments in differentiation and growth, both organic and via tuck-in acquisitions. As we prioritize investing in our business, you should expect us to be less aggressive on share repurchases in the near term. We are excited about the initiatives we are driving as we position the company for long-term value creation.

The second item relates to the founder's trusts that are significant long-term shareholders of IPG. The Gapontsev trusts have always operated with IPG's long-term interests in mind and have historically sold modest amounts in the open market under Rule 144 to cover their expenses. Since Trust one and three's remaining shares are not currently eligible to be sold under Rule 144, we plan to file a resale registration statement following our 10-K to facilitate an orderly distribution of shares over the next three years to cover expenses and diversify trust assets. The total amount of shares to be registered represents approximately 5% of IPG's total

outstanding shares today. The Trusts have indicated that they intend to remain significant long-term shareholders and support our strategy.

In closing, IPG is a great company with enormous potential. I am confident that with our continued focus on innovation and execution, we are well-positioned to leverage our strengths to drive sustained growth.

With that, I will now turn the call over to Tim.

Tim Mammen:

Thank you Mark, and good morning everyone. My comments will generally follow the earnings call presentation which is available on our investor relations website.

I will start with the financial review on slide 4.

Revenue came in at the top of our guidance in the fourth quarter at $234 million, up slightly on a sequential basis despite the full-quarter impact from the disposal of Russian operations and only a modest revenue contribution from cleanLaser. Revenue was down 22% year over year, and down 18% excluding divested operations. Foreign currency reduced revenue by approximately 1% this quarter. Revenue from materials processing applications decreased 24% year over year, primarily due to lower sales in welding, cutting, and marking applications while sales increased in additive manufacturing and micro-machining applications. Revenue from other applications decreased 6% due to lower sales in medical, partially offset by increased sales in advanced applications.

GAAP gross margin was 38.6%, an increase of 40 basis points year over year and above our guidance, driven by lower product costs and a decrease in import duty and shipping costs, partially offset by lower absorption of manufacturing expenses as a result of lower revenue. Continued effort to right size inventory resulted in a more moderate impact from inventory provisions.

Operating expenses were below our guidance range because of a one-time benefit from stock-based compensation expense and were down both year over year and sequentially due to the disposition of our Russian operations and controlled spending. Currency translation had a minor impact on revenue and gross profit in the quarter of approximately $2 million and $1 million,

respectively. Foreign currency transaction gains had a positive impact on operating income of $1 million.

GAAP operating income was $14 million and reported net income was $8 million, or $0.18 per diluted share. The effective tax rate was 64% in the quarter due to certain unusual tax items primarily related to repatriation of cash, which impacted the quarter by $3.4 million and earnings by $0.08 per share. In addition to this item, the effective tax rate was impacted by no tax benefits from losses in certain regions, other discrete items and the geographic spread of income in the quarter.

Now, let's look at our revenue by application, which we provide an update on annually. Welding was 37% of total sales in 2024 and was down year over year due to weakness in general industrial manufacturing and automotive, including EV battery manufacturing, compared to a strong 2023. Cutting revenue continued to decline and represented 21% of total revenue in 2024. We saw soft demand in general manufacturing and e-mobility markets across all regions and our OEM customers went through inventory destocking due to a lack of market recovery in the second half of the year. Competition continued to impact cutting sales in China, although these represent less than 5% of our consolidated revenue. Our OEM customers are seeing some increased competition from low-cost Chinese laser cutting system suppliers selling outside of China and we are working closely with customers to help them maintain their market share. Medical bounced back significantly in the fourth quarter, but was down slightly for the year adjusting for the divestiture of Russia. We expect medical to grow in 2025 with more significant revenue increases in 2026 and beyond. Medical is one of the attractive areas with strong growth opportunities that Mark detailed.

Moving to the revenue performance by region on slide 6. Sales in North America increased 6% sequentially, but were down 31% year over year due to lower sales in welding applications as a

result of a large e-mobility purchase in the prior year that did not repeat this year. Our medical orders from a large customer improved significantly from the prior quarter, but were still down year over year.

Excluding divested revenue, sales in Europe increased 5% sequentially driven by growth in additive manufacturing and advanced applications. European sales declined 22% year over year due to lower sales in cutting applications as the industrial demand environment remained weak.

Revenue in China decreased 10% sequentially and 22% year over year due to lower sales in cutting and welding applications to general industrial and e-mobility customers, which was partially offset by growth in additive manufacturing.

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 $930 million and no debt. Cash provided by operations was $74 million and capital expenditures were $23 million during the fourth quarter. Despite revenue being down this year, we continued to generate strong cash flow from operations and positive cash flow from inventory as we manage our investment in working capital. We sold two buildings earlier this year, realizing $25 million in proceeds and our capital expenditures for the full year came in at approximately $99 million, which was well below our earlier expectations. However, some projects were delayed and will drive higher capital spending in 2025. We spent $57 million on share repurchases in the fourth quarter and $344 million for the full year.

Moving to our outlook on slide 9, for the first quarter of 2025, we expect revenue of $210 million to $240 million. We expect the first quarter gross margin to be between 36% and 39%. As Mark alluded to, we are increasing investments in the growth of our business. As a result, our operating expenses are expected to be between $82 million to $84 million in the first quarter, and we expect these expenses to increase further in the second quarter and remain elevated

over the course of the year. We anticipate delivering adjusted earnings per diluted share in the range of $0.05 to $0.35, with approximately 43 million diluted common shares outstanding. The adjusted EPS excludes amortization, acquisition-related charges and any other non-recurring items. First-quarter adjusted EBITDA, which excludes stock-based compensation, is expected to be between $19 million and $35 million. We are planning on providing these Non-GAAP financial metrics starting in the first quarter of 2025 to help you keep track of our underlying financial performance.

We expect our 2025 capex to be between $105 million and $115 million. The increase is primarily related to investment in manufacturing capacity in Germany in order to replace fiber and other critical production that we lost access to in Russia. As mentioned earlier, a significant part of the 2025 expenditure relates to this project that was deferred from 2024. We continue to expect our normal maintenance capex to return to less than 5% of revenue once these critical investments are completed in the next 12 to 15 months.

In closing, I would like to highlight that our team remains focused and continues to execute well through the current environment. As we prioritize near-term investment in our future opportunities, we believe that these initiatives strengthen our foundation and position us well to deliver healthy operating leverage as the company returns to growth. We will also be able to improve free cash flow even further as we complete our near-term capex commitments.

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.