

IPG Photonics Corporation
Third Quarter 2024 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' third 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, October 29, 2024 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. Our third quarter revenue came in at the high end of our guidance adjusted for the sale of our Russian operations in August. Adjusted earnings per share also came in at the top end of the guidance. We continue to focus on what we can control while navigating a demand environment that has remained muted. Since joining in June, I've focused on diving deep into key aspects of IPG's business and strategy. We're making good progress executing on our key initiatives and I'm even more excited about our future opportunities than when I joined. I'll share a few highlights.

I will start with the sale of our Russian operations. As I mentioned on our last call, our team has done a tremendous job since the start of the war in Ukraine, executing flawlessly to serve the needs of our customers by quickly rebuilding our manufacturing infrastructure to ensure we did not miss a single shipment. This was not an easy task. This quarter, we were finally able to completely exit Russia with the sale of our operations in the country. With this transition now in the rearview mirror, we are focusing on optimizing our global manufacturing footprint to drive better efficiency, while ensuring enough capacity for an uptick in demand in future quarters. In addition, we are working to decrease the cost of our products with a new generation of laser diodes that will also enable a significant reduction in the form factor of our high-power fiber lasers.

The second highlight is our announcement today that we signed an agreement to acquire cleanLASER, a leader in laser cleaning systems based in Germany. IPG has a strong track record of driving the usage of lasers in new applications and solutions and this remains a key part of our growth and differentiation strategy. This tuck-in acquisition advances our capabilities in the large and attractive cleaning market where we see a lot of opportunities. It will enable us

to expand the use of lasers more quickly into this area. The acquisition highlights our focus on long-term growth. I'll talk more about how cleanLASER fits within IPG's business shortly.

My review of the business confirms the strength of our product pipeline, technical know-how and future market opportunities. We have work to do to execute on these opportunities and we're going to be investing in a number of key areas. We will make sure we're allocating resources to capitalize on high-value programs in areas such as medical, cleaning and micro-machining, and also strengthening the organization to ensure we are optimized to execute on these opportunities. We have a robust product pipeline that presents attractive opportunities to drive differentiation around lasers and systems, and to deliver complete solutions, process know-how and world-class support to our customers. All of this cannot be easily replicated by competitors. Our focus will remain on providing a high level of service and support, maximizing uptime and lowering the total cost of ownership for our customers.

On the organization front, we need to get stronger to ensure we are executing at a high level. This includes how we drive decisions, efficiency throughout the organization, and our go-to-market approach. We will be making some investments here that I'll provide more color on in future calls, but the main theme is that we are going to be stronger operators and more formidable competitors as we exit the current demand downturn. Because of the prolonged downcycle in the industrial market that we are facing, we need to make sure we are managing with agility as we invest for the long term. Over the past few months, we've achieved additional cost efficiencies and implemented cost avoidance initiatives, and, more recently, executed a targeted headcount reduction. We expect to reallocate these savings to opportunities that will drive long-term growth for IPG.

I'll have more to share on all the initiatives underway in coming months, but for now let me make it clear that we are moving purposefully and operating with agility as we put IPG in a strong position both for demand recovery and for long-term growth opportunities in our industry. And we are starting this from a solid foundation, with great products, customer relationships, strong cash flow generation and one of the industry's best balance sheets including a billion dollars in cash and no debt.

Let's now turn to the current business environment. Overall demand continues to bounce along the bottom. Customer conversations indicate a cautious spending environment across many markets, driven by economic and political uncertainty and reduced end-market demand in the key areas of general manufacturing and e-mobility. Our fourth quarter guidance reflects a continuation of this trend, and we currently don't have any visibility into an improved demand environment.

Turning to our key applications. In welding, revenue decreased modestly year over year primarily due to lower demand for e-mobility in China. Despite the year-over-year comparison remaining negative, it's important to note that welding sales have been relatively stable over the last three quarters and there are several good signs of progress for IPG. We are winning business with some large global customers in EV and general automotive applications, and driving further adoption of our welding solutions. Our real-time weld monitoring system is gaining acceptance with automotive and non-automotive customers where weld quality is critical for safe performance of their products. Additionally EV sales improved sequentially, which demonstrates that we are gaining market share in EV applications despite a downturn in battery capacity installations. I am also encouraged to see growth in our welding systems sales, with both automated systems and handheld posting better year-over-year results. Welding systems for medical device manufacturing are gaining traction around the world, and we are seeing strong

demand for our solutions in this market. We are having great conversations with important customers that indicate a favorable longer-term adoption curve, and we are well positioned for further gains. Overall, across welding applications, we continue to focus on the total solution for customers by providing best-in-class lasers, inline real-time weld monitoring and full automation to solve customers' manufacturing challenges.

In cutting, sales declined significantly year-over-year, primarily in Europe and U.S., as flat-sheet cutting remains weak. Amid an environment of weaker manufacturing PMI, our customers have not resumed normal purchasing activities although some of them have made progress working down inventories.

On a positive note, I continue to be enthusiastic about our opportunities in the growth areas where fiber lasers can replace incumbent technologies. That's the reason behind the cleanLASER acquisition as we look to increase our penetration into industrial cleaning applications. Cleaning is an important opportunity because traditional cleaning applications often rely on high levels of environmentally unfriendly consumables, such as acids and abrasives that must be disposed of. The processes may also involve high water consumption. By contrast, laser cleaning systems are environmentally friendly with limited or no process waste and have a compelling total cost of ownership. cleanLASER has a strong foothold in Europe as a long-time leader in the cleaning space. They have a wide array of customers in industries such as automotive, aerospace, medical, food and other markets. This is a great example of a targeted and prudent approach you will see us take in M&A activity. We've known the cleanLASER team and have supplied our laser sources to them for a number of years. Our businesses are complementary in many ways, bringing together our respective strong customer bases in North America and Europe, as well as product and technology synergies. We believe that together we

can help accelerate the adoption of laser systems in industrial cleaning. Tim will provide some more details on the structure of the deal and its financial impact.

I want to emphasize that I am extremely excited about a number of products and technologies in development, so we will be doubling down on some of them over the next couple of years. While it is too early to share the details, I believe these products can provide significant differentiation for IPG in medical, micro-machining and advanced applications, all of which provide large and attractive market opportunities for us.

Moving to our outlook, our third quarter book-to-bill was 1, excluding Russian sales. As I mentioned earlier, we continue to believe we are bouncing along the bottom of this demand cycle. Across our geographies, we have seen some stability in demand in China, offset by continued macro uncertainty in Europe and U.S. We have limited visibility beyond the current quarter but are remaining hopeful for more stability in 2025.

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 5.

Revenue in the third quarter was \$233 million, a decline of 23% year over year and down 8% sequentially when adjusted for Russian revenue, which was \$7 million in the quarter. Revenue came in at the top of our guidance. Foreign currency did not have a meaningful impact on revenue this quarter. Revenue from materials processing applications decreased 22% year over year, primarily due to lower cutting sales, while revenue from other applications decreased 28% due to unevenness in medical and advanced application sales.

GAAP gross margin was 23.2%, a decrease of over 20 percentage points year over year, primarily due to excess inventory provisions which provided a 12.8 percentage point headwind to GAAP gross margin this quarter. Adjusted gross margin was 36.0%, above the midpoint of our guidance. Additionally, lower absorption of manufacturing costs, as a result of lower revenue and our continued effort to rightsize inventory, reduced gross margin by 660 basis points. These negative impacts to gross margin were partially offset by a decrease in import duty and shipping costs as well as a further decrease of \$5 million in sequential manufacturing expenses.

Most of the increase in inventory provisions was related to excess quantities of strategic electronic and diode components. The provision related to the electronic components was driven by the severe issues that affected the electronics supply chain over the past several years, which resulted in significant purchases of these items as a strategic backup. Given the slowdown in our business and unsuccessful attempts to sell the electronic inventory in the secondary market, the realizable value of these items is now uncertain. The provision for excess

diode components is a result of the transition from the current generation of diodes to the new, more cost-effective high-power platform. Although this transition will happen over the next 12 to 15 months, our analysis shows that we will not consume all the existing inventory.

Operating expenses came in at the low end of our expectations due to the sale of our Russian business and focus on operating efficiencies. Currency translation had a minor impact on revenue and gross profit in the quarter of approximately \$1 million. Foreign currency transaction losses had a negative impact on operating income of \$1 million, or \$0.02 per share.

GAAP operating loss was \$253 million and included \$198 million loss on sale of assets related to the disposal of our Russian operations and \$27 million in asset impairment charges due to recent EU trade controls which curtailed our ability to operate in Belarus. We are currently evaluating strategic options related to this business. As a result of these items, we reported a net loss of \$234 million, or \$5.33 per diluted share. Excluding loss on sale of assets, asset impairment charges and excess inventory provisions, our adjusted EPS was \$0.29 in the third quarter, at the top of our guidance. We have provided a reconciliation to adjusted net income and adjusted earnings per share in the press release and earnings call presentation.

Moving to the revenue performance by region on slide 6. Sales in North America decreased 20% year over year due to lower sales in cutting applications and a decline in medical revenue. Our medical orders from a large customer can fluctuate significantly quarter over quarter due to their inventory management practices, adding some unevenness to these revenues. Other applications performed better with growth in welding and marking. EV investment is being delayed in the region, but traditional automotive investments seem to be bouncing back slightly.

In Europe, sales decreased 29% compared to the prior year due to lower sales in cutting applications. Large cutting OEM customers continued to manage their inventories with only low

order rates as economic conditions in Europe continue to be weak and industrial demand remains muted.

Revenue in China decreased 27% year over year due to lower sales in cutting and welding applications as a result of soft demand in general industrial and e-mobility markets, which was partially offset by growth in 3D printing applications. Cutting sales were also impacted by the challenging competitive environment.

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 \$1.0 billion and no debt. Cash provided by operations was \$66 million and capital expenditures were \$23 million during the third quarter. We continued to generate cash from inventory as we manage our investment in working capital. The proceeds received from the divestiture of our Russian operations resulted in a net cash outflow of \$25 million. We spent \$74 million on share repurchases in the third quarter and \$286 million year to date. While maintaining a strong balance sheet, we have returned a significant amount of capital to shareholders through share repurchases since the beginning of 2021. As mentioned earlier, we signed a definitive agreement to acquire cleanLASER for approximately \$75 million.

Moving to our outlook on slide 9, for the fourth quarter of 2024, we expect revenue of \$210 million to \$240 million. The revenue guidance range is similar to the last quarter, but after adjusting for Russian sales, reflects an increase in revenue guidance range of \$10 million sequentially. The fourth quarter gross margin is estimated to be between 35% and 38%. We anticipate delivering earnings per diluted share in the range of \$0.05 to \$0.35, with approximately 44 million diluted common shares outstanding.

Let me provide additional guidance on the financial impact of the divestitures and acquisitions. The sale of Russia is expected to reduce our revenue by approximately \$40 million on an annual

basis, but should have a neutral impact on operating income as the business was running at approximately breakeven after the restructuring. Our total operating expenses will come down as a result of the sale, but the decrease will be partially offset by our annual merit increase. Furthermore, we will continue to invest in research and development and sales and marketing to support technology development and closer collaboration with customers.

The announced acquisition of cleanLASER, is expected to close in the fourth quarter, pending regulatory approvals, and is not a part of our guidance. We expect this acquisition to add approximately \$30 million to revenue in the first year. It will be approximately neutral to GAAP operating income due to accruals for earn-outs based on future growth and profitability targets for the business.

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. 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.