IPG Photonics Corporation
Second Quarter 2024 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' second 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, July 30, 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:

Good morning, everyone. I am excited to be here with you on my first earnings call as CEO of IPG Photonics. I look forward to meeting many of you and to talking more about our story and our plans at IPG. Before diving into our second quarter performance, I'd like to spend a moment on my background, why I took on this role, and what I've been focusing on since I joined just over seven weeks ago.

For the past 35 years, I have been actively involved with lasers and laser applications, leading different functions at Coherent and the Photonics Solutions division at MKS Instruments. I joined MKS to integrate the Newport acquisition and significantly improved the performance of the business over 5 years. During my career, I have always admired IPG, its industry leadership, culture of innovation and ability to drive fiber lasers into new use cases. I am thrilled to have joined such an innovative and dynamic organization and see a lot of great opportunities ahead of us.

Since joining in June, I've focused on diving deep into key aspects of the business. The dedication, creativity and passion of IPG's team is truly inspiring, and conversations with employees have given me an even deeper appreciation of the team's knowledge and expertise. I am especially excited about IPG's R&D pipeline. I believe we have a number of projects in process that will put us in a strong position to extend our industry leadership, provide further differentiation and reduce product costs. I know that in the current macroeconomic cycle we have seen competitors get more aggressive, particularly in cutting. Competition is expected, and as a leader, it's important to keep driving innovation. Our team has been focusing on multiple initiatives to increase technological moats around laser products and provide complete solutions and world-class support to customers, which cannot be easily replicated. We are clearly seeing these efforts bear fruit in the areas such as EV battery welding and 3D printing. We are also expanding into new applications and use cases for new fiber lasers in areas where we offer significant advantages relative to other laser and non-laser solutions, including efficiency, speed and environmentally-friendly solutions.

In the coming months, I will be working with my management team to enhance existing strategies and develop new goals and objectives that provide a foundation for IPG's success in the coming years. On the operational side, we will be investing in our business where we can generate attractive returns while managing our discretionary costs. I strongly believe that by providing our customers with the highest quality solutions, the best service, and optimizing our operational efficiency, we will be best positioned to drive shareholder value in the long term. Internally, we will prioritize continued focus on collaboration, growth and continuous improvement. I look forward to being able to share more details about these strategies with you in the future.

Moving on to the second quarter results, we continued to generate strong operating cash flow in a challenging demand environment, as we executed on inventory reduction initiatives. Second quarter sales and earnings per share were above the midpoint of our revenue guidance with overall demand conditions stabilizing at a low level, particularly in general manufacturing and EV markets. Revenue was relatively stable in Asia sequentially, and improved in North America, helped by stronger sales in the emerging growth products, such as LightWELD and medical. Trends in Europe continued to moderate with industrial markets facing persistent headwinds and macroeconomic uncertainty.

Turning to the key applications that we serve. In welding, revenue decreased year over year primarily due to lower demand in e-mobility, and partially offset by growth in handheld welding. However, I am pleased to see that welding revenue was stable sequentially and we were able to gain market share in Europe, winning EV customer accounts even in a challenging operating environment. IPG's strength is our unique knowledge of laser material interaction and process know-how that significantly increases speed and quality of welding. Putting this together with our real-time process monitoring enables meaningful yield improvements for customers. Our laser welding processes and real-time weld monitoring have been widely adopted in EV battery manufacturing where faulty welds can have catastrophic results. We feel very good about our competitive position when investment spending in EV battery capacity resumes. And furthermore, we saw a strong pickup in sales of our handheld welding solutions, driven by our new partnership with Miller Electric, a leader in welding solutions. Continuous innovations driving improved efficiency, smaller form factor and lower cost enabled the commercial viability of laser welding for metal fabricators and job shops, opening up a huge new market opportunity for IPG.

Moving on to our second largest application - cutting, which is where we have seen the greatest impact to our business over the past several years from Chinese competition. The good news is our China cutting OEM business now accounts for less than 5% of our total revenue. In our European, U.S. and Japanese businesses, we have a stronger competitive position and customers who value productivity and uptime. This business was impacted by our customers working down inventory as they manage through significantly lower end-market demand. Now we are starting to see those customers' inventories normalizing, but the overall demand conditions in general industrial markets remain weak, primarily in Europe. We have strong relationships with all of the major global cutting OEM customers and are confident the decline is macro driven. We are working closely with our customers to understand their needs, enhance our service capabilities and reduce product costs. This approach ensures that our products not only stand out from the competition, but also deliver higher value to our customers. We are excited to announce the launch of a series of innovative products over the next two quarters, which are designed to foster win-win relationships and solidify our market position.

I am particularly excited about the new growth opportunities for IPG where fiber lasers can replace incumbent technologies. There are areas where we can innovate to provide solutions to specific problems in a way that is much better for the environment as we are replacing processes that are typically done with harmful chemicals or a significant use of electricity. A perfect example would be cleaning and heating applications. IPG is extremely proud to provide the most energy efficient and environmentally friendly solutions in these areas. Medical is another exciting area for the company with significant barriers to entry. We have a strong growth pipeline in urology applications and are seeing robust demand in lasers for skin rejuvenation and lesion removal. We believe that new product launches in 2024 and 2025 will result in strong revenue growth opportunities for this business.

Moving to the outlook, our second quarter book-to-bill was below 1. We are seeing more stable demand sequentially in China, but macroeconomic uncertainty is still negatively impacting demand across general industrial markets and applications in Europe and North America. While we believe strongly in the future of EVs, the well-publicized slowdown in EV adoption in Europe and U.S. has prompted several customers to delay further investment in battery capacity around the world. Our prior expectation for a rebound in demand in second half seems less likely to materialize and we currently are not expecting to see a meaningful recovery in our laser sales until sometime in 2025.

Before I turn the call to Tim to discuss financial results, I would like to thank Dr. Scherbakov for his significant contributions to IPG and the laser community over the last 30 years. I would also like to thank the Board for their trust in me. I look forward to leading this company, pushing the boundaries of innovation and transforming the world around us by applying light in ways that improve life. With that, I will now turn the call over to Tim.

Tim Mammen:

Thank you Mark, 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 5.

Revenue in the second quarter was $258 million, a decline of 24% year over year. Foreign currency headwinds reduced revenue growth by approximately 2%. Revenue from materials processing applications decreased 28% year over year, while revenue from other applications increased 24%.

GAAP gross margin was 37.3%, a decrease of 610 basis points year over year due to lower absorption of manufacturing costs as a result of lower revenue and our continued effort to reduce inventory, which reduced gross margin by over 700 basis points; this was despite achieving a $23 million decrease in manufacturing expenses as compared to the prior year. Higher inventory provisions added another 200 basis points to the headwinds in the quarter. I am happy with the progress we are making on the inventory side, but more work needs to be done before we get back to more normalized levels. These negative impacts to gross margin were partially offset by a decrease in import duty and shipping costs.

Operating expenses came in at the low end of our expectations, due to reduced variable compensation, but increased year over year, primarily due to increased investment in research and development and sales and marketing.

FX headwinds also had a negative impact on revenue and gross profit in the quarter. If exchange rates relative to the U.S. dollar had been the same as one year ago, we would have expected revenue to be $6 million higher and gross profit to be $3 million higher.

GAAP operating income was $12 million and operating margin was 4.7%. Net income was $20 million, or $0.45 per diluted share. The effective tax rate in the quarter was 19% and benefited from certain discrete items.
Foreign currency transaction losses, as a result of remeasuring of foreign currency assets and liabilities to period-end exchange rates, had a negative impact on operating income of $3 million, or $0.05 per share. We continued to optimize our footprint and had a gain on sale of assets in the quarter, which increased operating income by $1 million and increased diluted EPS by $0.01.

Moving to revenue performance by region on slide 6. Sales in North America decreased 2% year over year. We saw a strong growth in medical, 3D printing and advanced applications, which was offset by lower revenue in cutting, welding, and cleaning applications. Sales in North America held up relatively well, but macro headwinds have continued in the general industrial markets as well as led to reduced EV investments. In addition, continued inventory management by cutting OEMs is leading to more uncertain outlook in the region.

In Europe, sales decreased 27% compared to the prior year. Similar to the trends we saw in North America, cutting sales were impacted by large OEM customers reducing purchases as they managed their inventories. Economic conditions in Europe seem to be deteriorating further and impacting investments in industrial and automotive markets. EV investment is also delayed and current projects are being pushed out into 2025.

Revenue in China decreased 34% year over year as demand declined in general industrial and e-mobility markets, negatively impacting sales across cutting and welding applications. On the other hand, sales to cleaning and 3D printing applications continued to increase in the region. China revenue improved sequentially and we are seeing some stabilization there.

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 $1.1 billion and no debt. We continued to manage inventory, reducing it by $31 million from the prior quarter. We are targeting further reductions in inventory over the course of 2024. Cash provided by operations was $53 million and capital expenditures were $24 million during the second quarter.

While maintaining a strong balance sheet, we have been returning a significant amount of capital to shareholders through opportunistic share repurchases. We spent $122 million on share repurchases in the second quarter and $212 million year to date. Since the beginning of 2021, we have returned over $1 billion to shareholders through share repurchases.

Moving to our outlook on slide 9, for the third quarter of 2024, we expect revenue of $210 million to $240 million. The third quarter gross margin is estimated to be between 34% and 37%. We anticipate delivering earnings per diluted share in the range of $0.00 to $0.30, with approximately 45 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 "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.