IPG Photonics Corporation

First-Quarter 2015 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' first-quarter 2015 conference call. Today's call is being recorded and webcast. At this time, I would like to turn the call over to Angelo Lopresti, IPG's Senior Vice President, General Counsel and Secretary, for introductions. Please go ahead sir.

Angelo Lopresti:

Thank you and good morning everyone. With us today is IPG Photonics' Chairman and Chief Executive Officer, Dr. Valentin Gapontsev, and Senior Vice President and Chief Financial Officer, Tim Mammen.

Statements made during the course of this conference 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 known and unknown 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 include those detailed in IPG Photonics' Form 10-K for the year ended December 31, 2014 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 only as of today, April 28, 2015. The Company assumes no obligation to publicly release any updates or revisions to any such statements. We will post these prepared remarks on our website following the completion of the call. I'll now turn the call over to Dr. Valentin Gapontsev.

Valentin Gapontsev:

Good morning everyone.

IPG delivered another strong quarter and we are off to a terrific start in 2015. Revenues grew 17% year-over-year to $199.0 million, despite significant foreign exchange headwinds. Underlying growth for the quarter would have been more than 25% using average exchange rates for last year. And if we used average exchange rates from Q1 2014, our first quarter 2015 revenue would have been about $220 million. Gross margin was 54.2% and EPS was $1.08, up 40% compared with the same quarter last year. We had a sizable foreign exchange transaction gain in the quarter, which improved the bottom line by $0.11 per share.

IPG continues to grow the breadth and depth of our existing applications, and our products are being tested for use in new applications. For example, during the quarter, we continued to see good traction out of welding and we are actively pursuing various new applications within that market. In fact, we have developed and are preparing to introduce on the market two new 2D cutting technologies. The first one opens an opportunity for high quality cutting for a variety of thick metals like steel, aluminum, titanium, tungsten and others with a thickness 3 to 10 cm, and includes a process technology package, high grade cutting tables of 3 to 12 meters in length, a new generation of IPG's highly efficient 10-15 kW fiber lasers and unique cutting heads holding up to 20 kW in optical power. The second solution is a fine cutting technology for highly reflective metals like copper, gold and others. It is based on IPG's new kW class single mode green fiber lasers. Additionally, in Q1 2015 IPG installed in customer sites the first high quality pipe cutting machine as well as a 5D cutting machine for a large parts having complicated shapes.

In Q1, we experienced an acceleration in sales to our Japanese cutting OEMs, with cutting sales in Japan up more than 39%. We capitalized on Japanese cutting OEMs switching to fiber laser sources.

The Q1 2015 quarter opened for us new exciting opportunities for fiber lasers in welding applications also. We have finished qualification of new, LSS-5 generation of laser seam stepper technology. The system satisfies the most technical wishes of various end-users and became very competitive to industrial spot welders in pricing.

There is a great deal of interest in our new one-of-a-kind 3-beam fiber laser system for brazing of zinc coated steel parts in the automobile industry. The elegant, patent-pending IPG solution resolves very significant technical limitations of other processes. Currently we are finishing successful production tests with one of the largest car manufacturers and we expect to start mass deployment in the second half of the year. The other version of the same system looks very hopeful for an essential increase in aluminum welding quality. The growing use of aluminum in autos and other industries saves weight and increases fuel economy. So, aluminum welding continues to be a strong opportunity for us.

Further, during the last few months, our Russian company has developed a better technology for laser welding of thick steel (up to 10 cm), titanium (up to 5 cm) and other metals. On the basis of these results, we have started some very large scale projects in the oil industry, large bridge sections and other similar products manufacturers. For example, in Q1 we achieved good progress in the development of mobile machine for oil pipe casing welding. The direct tests of our equipment in the field, on the well drilling stations, should start next month.

In China, we see strong growth spending on R&D for complex welding in aerospace, specifically for replacing rivets on airframes.

In addition, sales of our family of QCW lasers for low power and fine welding applications, continued to grow. These lasers are used for battery and electronics welding in consumer electronics. As a result, QCW laser sales performed well as a replacement for inefficient lamp pumped YAG lasers. We expect this trend to continue going forward.

Another area that continues to grow for us is the use of fiber lasers for additive manufacturing. Fiber lasers are now widely used in this area which includes 3D printing, laser sintering and cladding applications. This application grew by more than 60% compared to Q1 2014. Sales to our core European customer group remains strong, while we are gaining OEMs in China, the U.S.A. and Japan where there is an increasing number of additive manufacturing customers. We combine such sales with internal development of complete solutions for some specific, large scale new applications. One of such projects is directed for mass use in high speed train car manufacturing. The other has a good chance to be implemented worldwide in large steel manufacturing. We have very serious customers in both cases.

Whereas various metal processing technologies still remain the dominant applications for IPG, we have made in Q1 remarkable progress in development of new, nonmetal directions. In fact, the qualification of our revolutionary, new short picosecond and femtosecond laser family is finished, and we are starting deployment of such lasers with an average power up to hundred watts to the medical and industrial markets.

We have reached very good results in the development of new technology for silicon polycrystal films annealing on the basis of our high power UV fiber lasers, which we believe has a good chance to replace the present excimer laser technology in OLED display manufacturing. Further, a new, state-of-the-art RGB technology platform, based on specle-free high power red, green and blue fiber lasers, has been developed by us which resolves the demand of high grade 3D cinema theatres projector manufacturers for efficient, super high lumen projectors.

Finally, I should mention the high volume requests for efficient paint removal systems for aircraft and ships. Now, the long-term project is turning from qualification to the mass deployment phase, and IPG fiber lasers are playing the role of an excellent engine there. Recently we received a request from a leading customer to become a key supplier of complete systems. Other large volume potential projects include fiber laser lidar sensors for driver-free vehicles and many other applications.

We believe we are operating from a strong position in our core applications. Overall, we are extending our lead over competitive lasers and non-laser methods by delivering the lowest cost, highest quality and most reliable lasers in the market today. With increased reliability, lower maintenance and ease of use, fiber laser technology is now becoming a preferred processing solution. In addition, our vertically integrated business model, manufacturing scale, extensive IP portfolio and drive to be the industry's greatest innovator provide high barriers to effectively compete with us.

During the quarter, we acquired a 76% interest in a technology company that developed key tools and controls for unique high power 5D laser systems. The focus will be on laser processing systems for cutting, welding, cladding and prototyping applications where lasers are not typically used. The systems will use our laser sources. These sources will be integrated with CNC and complex electric drive systems, electric controls and software technology in combination with specialized optical heads. At this point, the company is serving the Russian market, where it is located.

As our Q1 results indicate, we are off to a very good start to the year. Our backlog, order flow and book-to-bill remain at very strong levels in our three main geographies and we expect that to continue in the near term. We remain focused on gaining share in our established materials processing applications, developing new product applications that will expand our available market and applying our lasers in large scale and novel applications beyond our core applications in materials processing.

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

Tim Mammen:

Thank you Valentin and good morning everyone.

First-quarter revenue grew 17% to $199.0 million from $170.6 million a year ago.

Materials processing sales increased 18% year-over-year to $192.0 million, accounting for approximately 97% of total sales during the quarter. The continued strong performance of materials processing was driven primarily by cutting, welding and 3D printing applications.

Sales to other markets, including advanced applications, telecom and medical applications, which accounted for approximately 3% of IPG's total revenue, decreased by approximately 11% to $7 million. The decrease was the result of lower sales in advanced applications, partially offset by sales growth in both telecom and medical. As a reminder, advanced applications sales are typically large and uneven from quarter to quarter.

High-power laser sales, which accounted for 57% of total revenue, increased 14% year-over-year to $114.3 million. This growth, which demonstrates our continued leadership in this area of the market, was driven primarily by strong demand in cutting and welding applications as previously described by Valentin. In addition, we sold several high power 5-kw single mode lasers for a unique application related to patterning structured steel to alter its electromagnetic composition. Note that high-power laser revenues were most affected by currency headwinds.

Low-power pulsed laser sales decreased due to lower average selling prices while unit sales increased. This demonstrated our ability to compete more effectively with this product line. At the same time, there was strong demand for our high-power pulsed lasers primarily for marking and engraving applications and also cleaning and ablation, which resulted in pulsed laser sales increasing by 3% year-over-year to $29.9 million.

Sales of medium-power lasers rose 26% to $21.9 million, or 11% of total revenues. This growth continues to be driven by sales for fine-processing applications particularly cutting of thinner materials and also from 3D printing applications.

Sales of QCW lasers, which are mostly used for fine welding, percussion drilling of holes and some glass cutting, increased by 79% year-over-year to $10 million and accounted for 5% of total revenues. Sales were mostly driven by fine welding.

Revenue from low-power lasers decreased 8% to $3.5 million. Sales of other products, which include amplifiers, diode lasers, green lasers, mid-IR lasers, integrated laser systems and certain components, increased 18% year-over-year to $8.0 million.

Service, parts, lease and other revenue, including accessories, totaled $11.3 million net of deferred revenue of $2.4 million, an increase of 40% from $8.1 million last year when deferred revenue totaled $3.8 million. Included in this category are optical heads which we note are gaining traction with customers as more high power and other lasers are ordered with our proprietary welding heads.

Now looking at our Q1 performance by geography…

Sales in Asia increased to $104.5 million, or by 16% year-over-year. Within that region, China sales increased 23% to $56.5 million. Demand was driven across all product lines, most notably high power, QCW, and medium power lasers for cutting and welding applications. Our sales force in China continues to leverage the growth in that region and we expect the momentum to continue.

In Japan, sales decreased 15% year-over-year to $20.8 million. As a reminder, Japan had very strong results a year ago due to the change in consumption tax that resulted in an increase of purchasing activity in the first quarter of 2014. At the same time, the trend of Japanese cutting OEMs transitioning to fiber lasers continues to gain momentum in Q1, up 39% as Valentin previously mentioned.

In Turkey, we continued to benefit from strong demand from our cutting OEMs. In other parts of Asia, growth was driven by specialty lasers for the steel industry.

Notwithstanding slow growth of the economy in the Eurozone, European sales grew 15% year-over-year to $65.1 million, driven by even stronger growth in Germany from sales to the automobile and 3-D printing industries, partially offset by weakness in Russia related to the economic environment. We expect demand for 3D printing applications to continue to grow. Also, German pulsed laser sales performed well during the quarter.

North American sales increased 25% year-over-year to $28.6 million although this comparison is to a weak Q1 in 2014. The strength in the U.S. centered on cutting applications, automotive welding, and an improvement in sources for medical devices. In addition, QCW sales for low power welding and aerospace applications were strong.

Now, working our way down the income statement . . .

Gross margins of 54.2% were at the top end of our range of 50% to 55% as a result of the strong revenue performance, benefit related to lower manufacturing costs due to the depreciation of the Euro and Russian Ruble exchange rates and some benefit from product mix related to increased high-power, medium power and QCW sales partially offset by increased unit sales of low power-low cost pulsed lasers.

Sales & Marketing expenses decreased to 3.8% of sales, or $7.5 million, from 4.2% of sales, or $7.2 million, a year ago. We saw an increase in real dollars, but a decline in the percentage of sales as we benefited from leverage in the model.

As a percentage of sales, R&D expenses were down slightly at 7.2%, compared with 7.5% of sales, a year ago. In real dollars, R&D expenses increased to $14.2 million from $12.8 million a year ago, as we added to R&D headcount in the U.S. and Russia.

General & Administrative expenses decreased to 6.4% of total sales, or $12.8 million, from 7.6%, or $12.9 million, a year ago. This was primarily due to lower provisions for, and an increase in recoveries for, bad debt as well as a smaller loss on the disposal of fixed assets that benefited G&A by about $1.2 million in total. Excluding these amounts, G&A expenses were approximately $1.1 million or 9.4% higher than the first quarter of 2014 due to an increase in salaries and benefits, stock based compensation and depreciation.

In each of the aforementioned categories, operating expenses benefited to some degree from the depreciation of the Euro and other currencies.

Operating expenses for the first quarter were $25.8 million, including a foreign exchange gain of $8.8 million, compared with $31.5 million a year ago, which included a foreign exchange gain of $1.4 million. Excluding the foreign exchange gain, operating expenses for the first quarter were $34.6 million, compared with $32.9 million a year ago.

The foreign exchange gain of $8.8 million related to a position to build up dollar-based assets in Germany. The majority of that gain primarily came out of the depreciation of the Euro. The FX gain had a bottom-line benefit of $0.11 per share.

First-quarter operating income was $82.0 million, or 41.2% of sales, compared with $57.8 million, or 33.9% of sales, in the first quarter of last year. Excluding foreign exchange transactions gains and losses, operating margins were 36.8% and 33.1% in 2015 and 2014, respectively.

Our tax rate in the first quarter was 30.0% and does not include any benefit related to potential R&D tax credits which might become available later in the year if the credit legislation in the U.S. is re-enacted.

Net income for the first quarter increased by 41.5% to $57.4 million. On a diluted per share basis, we reported $1.08 for the first quarter compared with $0.77 a year ago. Excluding the benefit related to foreign exchange transaction gains during the quarter, EPS was $0.97.

If exchange rates relative to the U.S. Dollar had been the same as one year ago, which were on average Euro 0.73, Russian Ruble 35 and Japanese Yen 103, respectively, we would have expected revenue to be $21.6 million higher, gross profit to be $10.9 million higher and operating expenses would have been $4.1 million higher.

Now, turning to the balance sheet…

We continue to maintain a strong balance sheet, ending the quarter with cash and cash equivalents of $541.5 million, and $32.7 million of debt including lines-of-credit.

At March 31, 2015, inventory was $174.1 million, up 2% from $171.0 million at year end 2014. Our current level of inventory on hand amounts to approximately 172 days, compared with our target range of less than 180 days.

Accounts receivable were $149.8 million at the end of the first quarter, or 68 days' sales outstanding, compared with $143.1 million at December 31, 2014, or 63 days' sales outstanding, primarily due to the timing of shipments during the quarter and also payments received after the end of the quarter.

As Valentin discussed before, during Q1, we closed on an acquisition of a systems technology company that has unique multi-dimension high power systems platform for large scale cutting, welding and cladding applications. As a result of the acquisition, intangible assets increased by approximately $6.3 million.

Cash provided by operations during the quarter was strong at $52.0 million.

Capital expenditures and amounts related to acquisitions for the quarter totaled $18.8 million, including the $5.0 million cost of the acquisition. We continue to expect the capex run-rate for the full year 2015 to be approximately $60 to $65 million, excluding business acquisitions.

We are off to a strong start to the year. In the first quarter, book-to-bill was above 1 and we saw strength across the board in our largest markets. We expect that to continue as the year progresses. We continue to work with new customers and on new applications in cutting and welding in order to capitalize on the growing demand in our end markets; we are focused on establishing partnerships with new OEMs and end-users, and deepening our relationships with our existing customers.

And now for our expectations …

We currently expect revenues for the second quarter to be in the range of $215 million to $225 million. We anticipate Q2 earnings per diluted share in the range of $1.05 to $1.15. The mid-point of this guidance represents quarterly revenue and EPS growth of approximately 14% and 20%, respectively, year-over-year.

The EPS guidance is based upon 53,267,000 diluted common shares, which includes 52,486,000 basic common shares outstanding and 781,000 potentially dilutive options at March 31, 2015. This guidance is subject to the risks we outline in our reports with the SEC, and assumes exchange rates relative to the U.S. Dollar of Euro 0.93, Russian Ruble 52 and Japanese Yen 119, respectively. I want to reiterate that we do not attempt to forecast transaction gains or losses related to changes in exchange rates.

With that, Valentin and I will be happy to take your questions.

After Q&A

Valentin:

Thank you for joining us this morning. We look forward to speaking with you on next quarter's call.