IPG Photonics Corporation

Fourth-Quarter 2014 Conference Call Prepared Remarks

Operator:

Good morning, and welcome to IPG Photonics' fourth-quarter 2014 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, 2013 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, February 20, 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 year of record revenues in 2014, growing our top line 19% from 2013. The bottom line growth of 29% showed the ability of our vertically integrated business model to drive leverage in our operating profits even after the substantial investments we made in 2014 and prior years. We continued to grow our breadth of applications, we saw fiber laser penetration in the major application of cutting continue to grow rapidly, and we improved our competitive position in the automotive market. In addition, the growth we anticipated in laser sintering and 3D printing at the beginning of the year was achieved with sales growing by more than 100% for those applications.

The breadth of our applications is growing and our products continue to be evaluated for new applications. In the automotive industry we have made significant progress in developing a unique multi-laser beam process for welding and brazing hot zinc coated steel. The application is generating excitement and interest from leading automotive manufacturers. In addition, we recently shipped two 50kW lasers to NASA for a materials testing application.

Sales of our cutting and welding heads are starting to increase as these accessories become more widely accepted in the market and we added to the features and capabilities of the optical heads. Every high power laser used in metal processing uses a processing head so that we should be able to increase sales of these accessories from a couple of hundred units per year to many thousands over the next few years.

The laser market continues to grow at a significantly faster rate than GDP as lasers are being adopted across both existing and new applications. The total industrial laser market is expected to grow at about 5% in 2015 with industrial fiber laser growth expected to be significantly higher at about 13% after taking into account foreign currency headwinds. Excluding foreign currency headwinds, some industry analysts expect the growth of the fiber market to be in the range of 17% to 18%.

In 2014, industrial fiber laser sales were estimated to have increased by about 14% while IPG's material processing sales increased by 20%. While this may seem to indicate that we are gaining market share, it is more likely that the market is growing faster than estimated by analysts.

Current industry analysis points to the fact that, for the first time, total industrial fiber laser sales exceeded CO2 laser sales in 2014. With total fiber laser sales expected to exceed CO2 lasers by more than 20% in 2015, the gap is expected to continue to widen. Fiber laser sources are now the largest laser source in U.S. Dollar terms, largely based upon progress in macro, low and mid power IR-applications. Within a few years, we expect that fiber laser sales will exceed the combined value of all other industrial laser sources, one of our target markets, with the continued generational switch to fiber lasers and the introduction of UV and ultra-fast fiber lasers.

In short, our competitive position continues to be very strong. We are extending our lead by delivering the lowest cost, best and most reliable lasers in the market. With increased reliability, lower maintenance and ease of use of fiber lasers, laser technology is now becoming a preferred processing solution rather than a choice of last resort. In addition, our vertically integrated business model, robust IP portfolio and manufacturing scale provide high barriers to entry.

We enter 2015 with a strong backlog and remain focused on gaining further share in our established materials processing applications, completing development of and introducing new products which will expand our available market and applying our lasers in large scale and novel applications beyond our core applications in metal processing. For example, we continue to make progress in the development of our green, UV and ultra-fast fiber lasers. Currently we have several units undergoing long-term testing, and we are being careful to introduce products that meet the high quality standards that IPG is known for.

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

Tim Mammen:

Thank you Valentin and good morning everyone.

Fourth-quarter revenue grew 25% to $207.4 million from $165.9 million a year ago.

Materials processing sales increased 23% year-over-year to $191.0 million, accounting for approximately 92% of total sales during the quarter. The continued strong performance of materials processing was driven primarily by cutting, laser sintering and 3D printing applications.

Sales to other markets, including advanced applications, telecom and medical applications, which accounted for approximately 8% of IPG's total revenue, increased by approximately 57%, or by $6.0 million, to $16.4 million. This growth was primarily driven by two 50 kW fiber lasers that were shipped to the NASA Ames Research Center that Valentin mentioned, and another 50kW laser that was shipped for another advanced application. Orders for advanced applications are typically large in dollar value, but are not even from quarter-to-quarter.

High-power laser sales, which accounted for 56% of total revenue, increased 32% year-over-year to $116.2 million. This growth, which demonstrates our continued leadership in this area of the market, was driven primarily by strong sales for cutting applications, improved sales from automotive welding, as well as revenue from advanced applications.

Increased demand for our new low cost low-power and high-power pulsed lasers for marking and engraving applications resulted in pulsed laser sales increasing by 16% year-over-year to $32.0 million.

Sales of medium-power lasers rose 58% to $21.3 million, or 10% of total revenues. This growth continues to be driven by sales for fine-processing applications -- particularly cutting of thinner materials and also from laser sintering and 3D printing applications.

Sales of QCW lasers, which are mostly used for fine welding, percussion drilling of fine holes and some glass cutting, increased by 23% year-over-year to $6.8 million and accounted for 3% of total revenues. Sequentially, sales were lower due to the cyclicality of the fine welding projects for consumer electronics applications that we mentioned on our Q3 call.

Revenue from low-power lasers increased 9% to $3.2 million as a result of slightly higher medical sales.

Sales of other products, which include amplifiers, diode lasers, green lasers, mid-IR lasers, integrated laser systems and certain components, decreased 47% year-over-year to $9.6

million. The overall decrease was caused by a decline in system sales in Russia due to economic conditions and foreign currency devaluation there as well as having had a comparatively large system order in Q4 of last year.

Service, parts, lease and other revenue, including accessories, totaled $18.5 million, an increase of 76% from last year primarily due to increased sales of accessories and deferred revenue recognized in the quarter which totaled $2.9 million as compared to $0.6 million which was deferred in the fourth quarter of 2013. Excluding the change in deferred revenue service, parts, lease and other revenue increased by approximately 40%.

Now looking at our Q4 performance by geography…

Sales in Asia increased to $97.8 million, or by 36% year-over-year. Within that region, China sales increased 53% to $61.2 million. Demand was driven by applications such as cutting, welding, and marking and engraving. Our sales force in China has done a very nice job in leveraging the growth in that region.

In Japan, sales increased 4% year-over-year to $16.8 million as volume demand was partially offset by currency headwinds due to the weak Yen. In Turkey, we continued to benefit from strong demand from our cutting OEMs. We shipped a 5kW single mode laser to a customer in Korea for a specialty scribing application in the steel industry. This marks another design win for a new application as we continue to see an increase in fiber lasers displacing C02 technology.

European sales grew 8% year-over-year to $69.4 million, driven by strong growth from our cutting OEMs, partially offset by weakness in Russia related to the economic environment there. As previously mentioned, we also had a large system order in Russia a year ago. In Germany, in addition to cutting, we experienced significant demand for 3D printing applications and we expect that market to continue to grow. We also gained traction in the German automotive industry. A number of customers continue to evaluate the laser seam stepper around the world.

North American sales increased 31% year-over-year to $39.0 million. This growth was primarily related to project driven demand for high-power lasers used for welding applications in the U.S. and the increase in sales for advanced applications described above. We also had a big automotive win in the U.S. retrofitting lasers in a 3D robot cutting application in the auto industry.

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

Gross margins of 54.9% were at the top end of our target range of 50% to 55% as a result of the strong revenue performance which helped absorption during the quarter and some benefit from product mix related to increased high-power laser sales.

Sales & Marketing expenses increased to $7.9 million, or 3.8% of sales, from $7.2 million, or 4.3% of sales, 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.

Research & Development expenses increased to $13.8 million from $10.9 million a year ago. As a percentage of sales, R&D was up slightly at 6.7%, compared with 6.6% of sales, a year ago.

General & Administrative totaled $15.1 million, or 7.3% of total sales, compared with $13.0 million, or 7.9% of sales, a year ago.

Operating expenses for the fourth quarter were $34.3 million, including a foreign exchange gain of $2.6 million, compared with $32.7 million a year ago, which included a foreign exchange loss of $1.6 million.

Fourth-quarter operating income was $79.8 million, or 38.4% of sales, compared with $49.0 million, or 29.5% of sales, in the fourth quarter of last year. Excluding foreign exchange transactions gains and losses, operating margins were 37.2% and 30.4% in 2014 and 2013, respectively.

Our tax rate in the fourth quarter was 29.2%. While we had a benefit of $0.02 per share resulting from reenactment of the R&D tax credit which was signed into law at the end of the fourth quarter, this benefit was offset by other adjustments to the provision related to the amount of income arising in different tax jurisdictions and reserves for uncertain tax positions. As a result there was no substantial benefit to the effective tax rate in the quarter.

Net income for the fourth quarter increased by 54.2% to $56.4 million. On a diluted per share basis, we reported $1.07 for the fourth quarter compared with $0.70 a year ago. Excluding the benefit related to foreign exchange transaction gains and the lower effective tax rate during the quarter, EPS was $1.02.

If exchange rates had been the same as one year ago we would have expected revenue to be $10.6 million higher, gross profit to be $5.6 million higher and operating expenses would have been $2.4 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 $522.2 million, and $35.6 million of debt including lines-of-credit.

At December 31, 2014, inventory was $171.0 million, down 1% from $172.7 million at year end 2013. Our current level of inventory on hand amounts to approximately 168 days, compared with our target range of less than 180 days. However, the U.S. Dollar translated value of inventory benefited from the depreciation of the Euro and Russian Ruble. If the value of inventory was translated at the average exchange rates prevailing for the last three months the value of inventory would have been approximately $8.8 million higher.

Accounts receivable were $143.1 million at the end of the fourth quarter, or 63 days' sales outstanding, compared with $103.8 million at year the end of 2013, or 57 days' sales outstanding. The increase is primarily due to the timing of revenue during the quarter.

Cash provided by operations during the quarter was strong at $60.1 million.

Capital expenditures for the quarter totaled $15.9 million and were $88.6 million for 2014.

Backlog, which we report annually, was $321.0 million at December 31, 2014, compared with $265.0 million a year ago, representing a 21% increase. Our backlog includes $174.5 million of orders with firm shipment dates and $146.5 million of frame agreements that we expect to ship within one year, compared with $132.6 million of orders with firm shipment dates and $132.4 million of frame agreements at December 31, 2013. Book to bill for Q4 2014 was greater than one.

And now for our expectations …

Our solid execution in 2014 positions IPG well for a successful year ahead. In 2015 we are focused on qualifying IPG's products for new applications, establishing partnerships with new OEMs and end-users, and deepening our relationships with existing customers. We also will continue to control costs and temper our capital expenditures.

With that in mind, we currently expect revenues for the first quarter to be in the range of $195 million to $205 million. I should note that historically, first quarter revenues can typically be lower than the preceding quarter due to seasonality in our business. We anticipate Q1 earnings per diluted share in the range of $0.92 to $1.02. The mid-point of this guidance represents quarterly revenue and EPS growth of approximately 17% and 26%, respectively, year-over-year. It should be noted that if exchange rates were at a similar level to those in the same quarter one year ago, we would have expected our revenue guidance range to be up to $10 million higher and our forecast growth to be even stronger.

The EPS guidance is based upon 52,873,000 diluted common shares, which includes 52,153,000 basic common shares outstanding and 720,000 potentially dilutive options at December 31, 2014. This guidance is subject to the risks we outline in our reports with the SEC, and assumes that the exchange rates remain at present levels. I want to reiterate that we do not attempt to forecast gains or losses related to exchange rates. In addition, we expect capital expenditures for the full year 2015 will be approximately $65 million.

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.