

IPG PHOTONICS CORP
Form 10-Q
May 10, 2010

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Commission File Number 001-33155

IPG PHOTONICS CORPORATION

(Exact name of registrant as specified in its charter)

**Delaware
(State or other jurisdiction of
incorporation or organization)**

**04-3444218
(I.R.S. Employer
Identification Number)**

**50 Old Webster Road, Oxford, Massachusetts
(Address of principal executive offices)**

**01540
(Zip code)**

(508) 373-1100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

As of May 5, 2010, there were 46,213,493 shares of the registrant's common stock issued and outstanding.

TABLE OF CONTENTS

	Page
<u>Part I. Financial Information</u>	3
<u>Item 1. Unaudited Interim Financial Statements</u>	3
<u>Consolidated Balance Sheets: March 31, 2010 and December 31, 2009</u>	3
<u>Consolidated Statements of Operations: Three Months Ended March 31, 2010 and 2009</u>	4
<u>Consolidated Statements of Cash Flows: Three Months Ended March 31, 2010 and 2009</u>	5
<u>Consolidated Statements of Equity: Three Months Ended March 31, 2010 and 2009</u>	6
<u>Notes to Consolidated Financial Statements</u>	7-11
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	16
<u>Item 4. Controls and Procedures</u>	17
<u>Part II. Other Information</u>	17
<u>Item 1. Legal Proceedings</u>	17
<u>Item 1A. Risk Factors</u>	17
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	19
<u>Item 3. Defaults Upon Senior Securities</u>	19
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	19
<u>Item 5. Other Information</u>	19
<u>Item 6. Exhibits</u>	19
<u>Signatures</u>	20
<u>EX-12.1</u>	
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32</u>	

Table of Contents

PART I FINANCIAL INFORMATION
ITEM 1. UNAUDITED INTERIM FINANCIAL STATEMENTS
IPG PHOTONICS CORPORATION
CONSOLIDATED BALANCE SHEETS

	March 31, 2010	December 31, 2009
	(In thousands, except share and per share date)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 84,407	\$ 82,920
Accounts receivable, net	30,078	30,356
Inventories, net	52,135	52,869
Income taxes receivable	3,193	2,558
Prepaid expenses and other current assets	6,095	4,653
Deferred income taxes	9,253	7,558
Total current assets	185,161	180,914
DEFERRED INCOME TAXES	4,548	4,313
PROPERTY, PLANT AND EQUIPMENT, Net	109,639	111,453
OTHER ASSETS	15,859	15,956
TOTAL	\$ 315,207	\$ 312,636
 LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Revolving line-of-credit facilities	\$ 7,098	\$ 6,007
Current portion of long-term debt	1,333	1,333
Accounts payable	5,824	5,620
Accrued expenses and other liabilities	25,316	21,189
Deferred income taxes	322	503
Income taxes payable	4,236	2,179
Total current liabilities	44,129	36,831
DEFERRED INCOME TAXES AND OTHER LONG-TERM LIABILITIES	2,293	2,567
LONG-TERM DEBT	16,333	16,667
COMMITMENTS AND CONTINGENCIES		
IPG PHOTONICS CORPORATION STOCKHOLDERS EQUITY:	5	5

Edgar Filing: IPG PHOTONICS CORP - Form 10-Q

Common stock, \$0.0001 par value, 175,000,000 shares authorized; 46,125,191 shares issued and outstanding at March 31, 2010; 46,076,472 shares issued and outstanding at December 31, 2009		
Additional paid-in capital	294,724	293,743
Accumulated deficit	(45,027)	(48,424)
Accumulated other comprehensive income	2,582	11,106
Total IPG Photonics Corporation stockholders' equity	252,284	256,430
NONCONTROLLING INTERESTS	168	141
Total equity	252,452	256,571
TOTAL	\$ 315,207	\$ 312,636

See notes to consolidated financial statements.

Table of Contents

IPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2010	2009
	(In thousands, except per share data)	
NET SALES	\$ 51,204	\$ 45,408
COST OF SALES	30,657	29,547
GROSS PROFIT	20,547	15,861
OPERATING EXPENSES:		
Sales and marketing	4,338	3,189
Research and development	4,158	4,142
General and administrative	6,828	4,990
(Gain) loss on foreign exchange	(108)	1,515
Total operating expenses	15,216	13,836
OPERATING INCOME	5,331	2,025
OTHER (EXPENSE) INCOME, NET:		
Interest expense	(208)	(390)
Other expense, net	(66)	(148)
Total other expense	(274)	(538)
INCOME BEFORE PROVISION FOR INCOME TAXES	5,057	1,487
PROVISION FOR INCOME TAXES	(1,633)	(461)
NET INCOME	3,424	1,026
LESS: NET INCOME (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS	27	(245)
NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION	\$ 3,397	\$ 1,271
NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION PER SHARE:		
Basic	\$ 0.07	\$ 0.03
Diluted	\$ 0.07	\$ 0.03
WEIGHTED-AVERAGE SHARES OUTSTANDING:		
Basic	46,098	45,094
Diluted	47,191	46,152

See notes to consolidated financial statements.

Table of Contents

IPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	March 31,	
	2010	2009
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 3,424	\$ 1,026
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,226	4,380
Deferred income taxes	(2,409)	(4,174)
Stock-based compensation	770	635
Unrealized (gains) losses on foreign currency transactions	(106)	1,513
Other	(10)	(31)
Provisions for inventory, warranty and bad debt	1,718	3,728
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	(897)	10,281
Inventories	(3,349)	859
Prepaid expenses and other current assets	38	(1,626)
Accounts payable	(399)	(1,156)
Accrued expenses and other liabilities	3,634	(697)
Income and other taxes payable	236	2,772
Net cash provided by operating activities	7,876	17,510
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant, equipment and intangible assets	(4,953)	(4,686)
Acquisition of business, net of cash acquired	(748)	
Other	181	22
Net cash used in investing activities	(5,520)	(4,664)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from line-of-credit facilities	4,274	13,528
Payments on line-of-credit facilities	(3,112)	(3,298)
Purchases of noncontrolling interests		(455)
Principal payments on long-term borrowings	(333)	(344)
Exercise of employee stock options and related tax benefit from exercise	211	137
Net cash provided by financing activities	1,040	9,568
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(1,909)	(2,096)
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,487	20,318
CASH AND CASH EQUIVALENTS Beginning of period	82,920	51,283
CASH AND CASH EQUIVALENTS End of period	\$ 84,407	\$ 71,601

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid for interest	\$ 281	\$ 403
Income taxes paid	\$ 1,445	\$ 2,795
Non-cash transactions:		
Amounts related to acquisition of business included in accounts payable and accrued expenses and other liabilities	\$ 789	\$
Additions to property, plant and equipment included in accounts payable	\$ 119	\$ 365
Purchases of noncontrolling interests in exchange for Common Stock	\$	\$ 2,190

See notes to consolidated financial statements.

Table of Contents

IPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY

	Three Months Ended March 31,			
	2010		2009	
	(In thousands, except share and per share data)			
	Shares	Amount	Shares	Amount
COMMON STOCK				
Balance, beginning of year	46,076,472	\$ 5	44,965,960	\$ 4
Common stock issued in purchase of noncontrolling interests			293,146	1
Exercise of stock options	48,719		92,927	
Balance, end of period	46,125,191	5	45,352,033	5
ADDITIONAL PAID-IN CAPITAL				
Balance, beginning of year		293,743		283,217
Common stock issued in purchase of noncontrolling interests				2,190
Discount on purchase of noncontrolling interests				2,028
Exercise of stock options and related tax benefit from exercise		211		137
Stock-based compensation		770		637
Balance, end of period		294,724		288,209
ACCUMULATED DEFICIT				
Balance, beginning of year		(48,424)		(53,843)
Net income attributable to IPG Photonics Corporation		3,397		1,271
Balance, end of period		(45,027)		(52,572)
ACCUMULATED OTHER COMPREHENSIVE INCOME				
Balance, beginning of year		11,106		8,794
Translation adjustments		(8,452)		(6,939)
Unrealized (loss) gain on derivatives, net of tax		(72)		31
Balance, end of period		2,582		1,886
TOTAL IPG PHONTONICS CORPORATION STOCKHOLDERS EQUITY		252,284		237,528
NONCONTROLLING INTERESTS				

Edgar Filing: IPG PHOTONICS CORP - Form 10-Q

Balance, beginning of year	141	5,127
Net income (loss) attributable to noncontrolling interests	27	(245)
Purchase of noncontrolling interests		(2,645)
Discount on purchase of noncontrolling interests		(2,028)
Balance, end of period	168	209
TOTAL EQUITY	\$ 252,452	\$ 237,737

See notes to consolidated financial statements.

6

Table of Contents**IPG PHOTONICS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. BASIS OF PRESENTATION**

The accompanying unaudited interim consolidated financial statements have been prepared by IPG Photonics Corporation, or IPG, we, our, or the Company. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated financial statements include our accounts and those of our subsidiaries. All intercompany balances have been eliminated in consolidation. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in our annual report on Form 10-K for the year ended December 31, 2009.

Effective January 1, 2010, the functional currency of our Russian subsidiary was changed from the U.S. Dollar to the Russian Ruble due to other than temporary changes in the business that made the local currency the predominate transactional currency. As a result of this change in functional currency, the Company was required to change the method of translation of the financial statements of this business into U.S. dollars. From the effective date forward, the Company translates all assets and liabilities of the business into U.S. dollars using the exchange rate at the end of the period, income statement items are translated using rates in effect at the date that the transactions are recorded, and related translation adjustments are accumulated and charge to accumulated other comprehensive income.

In the opinion of our management, the unaudited financial information for the interim periods presented reflects all adjustments necessary for a fair presentation of our financial position, results of operations and cash flows. The results reported in these consolidated financial statements are not necessarily indicative of results that may be expected for the entire year.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, an updated accounting guidance was issued related to the separation criteria used to determine the unit of accounting for multiple element arrangements. This update removes the objective-and-reliable-evidence-of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, replaces references to fair value with selling price to distinguish from the fair value measurements required under the *Fair Value Measurements and Disclosures* guidance, provides a hierarchy that entities must use to estimate the selling price, eliminates the use of the residual method for allocation and expands the ongoing disclosure requirements. This guidance is effective for us beginning January 1, 2011, although early adoption is permitted, and adoption can be applied prospectively or retrospectively. We are currently evaluating the effect that implementation of this update will have, if any, on our consolidated financial position and results of operations upon adoption.

3. INVENTORIES

Inventories consist of the following (in thousands):

	March 31, 2010	December 31, 2009
Components and raw materials	\$ 17,092	\$ 17,801
Work-in-process	22,089	21,375
Finished goods	12,954	13,693
Total	\$ 52,135	\$ 52,869

The Company recorded inventory provisions totaling \$617,000 and \$1,390,000 for the three months ended March 31, 2010 and 2009, respectively. These provisions were recorded as a result of changes in market prices of certain components, the realizable value of those inventories through finished product sales and uncertainties related

to the recoverability of the value of inventories due to technological changes and excess quantities. These provisions are reported as a reduction to components and raw materials and finished goods. In addition, we recorded a \$1.3 million reduction in value of certain components in inventory in the three months ended March 31, 2009. This charge was related to a change in the standard cost of these components.

Table of Contents**4. FINANCING ARRANGEMENTS**

The Company's borrowings under existing financing arrangements consist of the following (in thousands):

	March 31, 2010	December 31, 2009
Revolving Line-of-Credit Facilities:		
Euro Credit and Overdraft Facilities	\$ 1,031	\$ 977
U.S. Line of Credit	6,067	5,030
Total	\$ 7,098	\$ 6,007
Term Debt:		
U.S. Long-Term Note	17,666	18,000
Less current portion	(1,333)	(1,333)
Total long-term debt	\$ 16,333	\$ 16,667

5. NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION PER SHARE

The following table sets forth the computation of diluted net income attributable to IPG Photonics Corporation per share (in thousands, except per share data):

	Three Months Ended March 31, 2010 2009	
Net income attributable to IPG Photonics Corporation	\$ 3,397	\$ 1,271
Weighted average shares	46,098	45,094
Dilutive effect of common stock equivalents	1,093	1,058
Diluted weighted average common shares	47,191	46,152
Basic net income attributable to IPG Photonics Corporation per share	\$ 0.07	\$ 0.03
Diluted net income attributable to IPG Photonics Corporation per share	\$ 0.07	\$ 0.03

The computation of diluted weighted average common shares excludes 492,000 and 1,399,000 shares for the three months ended March 31, 2010 and 2009, respectively, because the effect on net income attributable to IPG Photonics Corporation per share would have been anti-dilutive.

6. COMPREHENSIVE INCOME

Total comprehensive income (loss) and its components were as follows (in thousands):

	Three Months Ended March 31, 2010 2009	
Net income attributable to IPG Photonics Corporation	\$ 3,397	\$ 1,271
Other comprehensive income:		
Unrealized loss on derivatives, net of tax	(72)	31

Edgar Filing: IPG PHOTONICS CORP - Form 10-Q

Foreign currency translation adjustment	(8,452)	(6,939)
Comprehensive income (loss)	\$(5,127)	\$(5,637)

Table of Contents**7. DERIVATIVE FINANCIAL INSTRUMENTS**

Our primary market exposures are to interest rates and foreign exchange rates. We use certain derivative financial instruments to help manage these exposures. We execute these instruments with financial institutions we judge to be credit-worthy. We do not hold or issue derivative financial instruments for trading or speculative purposes.

We recognize all derivative financial instruments as either assets or liabilities at fair value in the consolidated balance sheet. We have used foreign currency forward contracts as cash flow hedges of forecasted intercompany settlements denominated in foreign currencies of major industrial countries. We have no outstanding foreign currency forward contracts. We have an interest rate swap that is classified as a cash flow hedge of our variable rate debt.

Cash flow hedges Our cash flow hedge is an interest rate swap under which we agree to pay fixed rates of interest. We have no derivatives that are not accounted for as a hedging instrument. The fair value amounts in the consolidated balance sheet at March 31, 2010 were (in thousands):

	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate swap	Other Assets	\$	Deferred income taxes and other long-term liabilities	\$ 1,242
Total		\$		\$ 1,242

The derivative gains and losses in the consolidated statement of operations for the three months ended March 31, 2010, related to our interest rate swap contract were as follows (in thousands):

Derivatives in Cash Flow Hedging Relationships	Pretax Gain Recognized in Other Comprehensive Income on Effective Portion of Derivative Amount	Pretax Loss on Effective Portion of Derivative Reclassified from Accumulated Other Comprehensive Loss Location		Ineffective Portion of Gain on Derivative and Amount Excluded from Effectiveness Testing Recognized in Income Location	
		Amount	Amount	Amount	Amount
Interest rate swap	\$ 59	Interest Expense	\$ 176		\$