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Apr 08, 2020

IPG Photonics Corp (IPGP)

$114.35 (As of 04/07/20)

Price Target (6-12 Months): **$97.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 02/19/20) Prior Recommendation: Neutral	**Underperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**5-Strong Sell**
	Zacks Style Scores:	VGM:F
	Value: F | Growth: F	Momentum: C

Summary

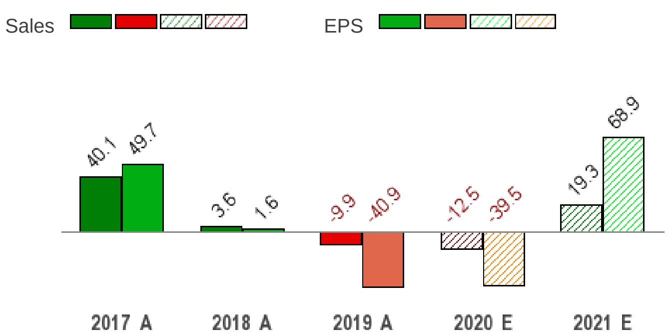
IPG Photonics is bearing the brunt of ongoing uncertainty in macroeconomic environment and geopolitical factors. Further, its exposure to the materials processing markets and customer concentration are major negatives. Additionally, the coronavirus outbreak remains a headwind, which has compelled the company to provide a bleak guidance for first-quarter revenues. Furthermore, increasing manufacturing cost and investments are likely to weigh on the company's margins. Notably, the stock has underperformed the industry in the past year. Nevertheless, growing momentum across QCW lasers and 10 kilowatts or greater high-power CW lasers remain noteworthy. Further, Genesis buyout benefits remain tailwinds. However, foreign-exchange headwinds, higher inventory, and impairment charges pertaining to restructuring, goodwill and other assets are concerns.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$182.17 - $98.04
20 Day Average Volume (sh)	608,903
Market Cap	$6.1 B
YTD Price Change	-21.1%
Beta	1.75
Dividend / Div Yld	$0.00 / 0.0%
Industry	Lasers Systems and Components
Zacks Industry Rank	Top 36% (91 out of 253)
Last EPS Surprise	16.7%
Last Sales Surprise	6.9%
EPS F1 Est- 4 week change	-9.2%
Expected Report Date	05/05/2020
Earnings ESP	-2.2%
P/E TTM	25.8
P/E F1	43.3
PEG F1	5.5
P/S TTM	4.6

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	286 E	335 E	355 E	372 E	1,372 E
2020	234 E	281 E	310 E	324 E	1,150 E
2019	315 A	364 A	329 A	307 A	1,315 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$0.75 E	$1.08 E	$1.23 E	$1.30 E	$4.46 E
2020	$0.18 E	$0.52 E	$0.78 E	$0.84 E	$2.64 E
2019	$1.02 A	$1.42 A	$1.08 A	$0.91 A	$4.36 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/07/2020. The reports text is as of 04/08/2020.

Overview

Oxford, MA-based IPG Photonics Corp develops and manufactures fiber & diode lasers, fiber amplifiers and transceivers that are used for diverse applications, like materials processing, advanced applications, communications and medical.

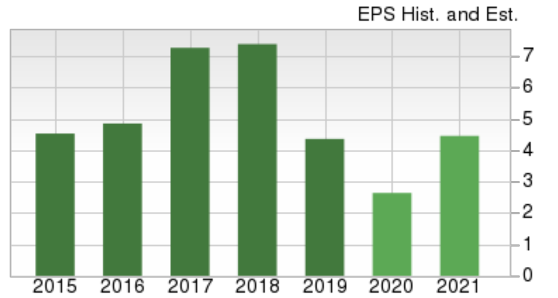
IPG's laser products include low (1 to 99 watts), medium (100 to 999 watts) and high (1,000 watts and above) output power lasers from 0.3 to 4.5 microns in wavelength.

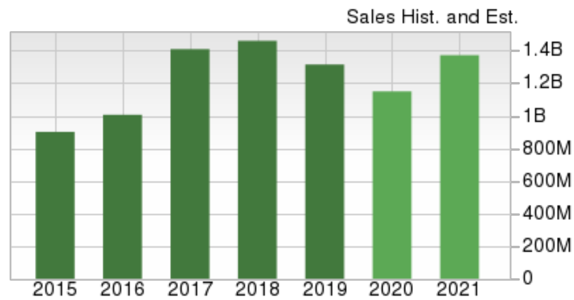
These lasers may be continuous wave (CW), quasi-continuous wave (QCW) or pulsed. The company's pulsed line includes nanosecond, picosecond and femtosecond lasers.

The company offers several different types of lasers according to the type of gain medium they use. These are ytterbium, erbium and thulium, as well as Raman and hybrid fiber-crystal lasers.

IPG's amplifier products range from milliwatts to up to 1,500 watts of output power from 1 to 2 microns in wavelength.

The company offers erbium-doped fiber amplifiers (EDFAs), Raman amplifiers, ytterbium & thulium specialty fiber amplifiers and broadband light sources.





Moreover, its transceivers provide interconnect, coarse wavelength division multiplexing (CWDM), DWDM, and tunable-based pluggable interfaces to serve optical transmission needs from 100 meters over multimode fiber to over 1,200 kilometers. The company added this product portfolio through the acquisition of Menara Networks.

IPG reported total revenues of $1.314 billion in 2019.

Geographically, United States and other North America, China, Germany and Japan contributed 21.4%, 37.4%, 6.2% and 5.5%, respectively to 2019 revenues.

Meanwhile, Other Eastern Europe/CIS, Other Asia and Australia, and Rest of the World accounted for 19%, 9.2% and 1.3%, respectively to 2019 revenues.

The company faces competition from the likes of Coherent, nLight, Maxphotonics, Raycus Fiber Laser Technologies, and Lumentum Holdings among others.

Reasons To Sell:

- IPG's significant exposure to the materials processing markets is a key headwind. Revenues from material processing offerings accounted for 93.5% of total 2019 revenues. Any downturn in this market will significantly impact top-line growth. Additionally, the company faces customer concentration risk in terms of geographic location. In 2019, 37.4% of the company's sales were derived from China and 19% of revenues were derived from Other including Eastern Europe/CIS. Moreover, five largest customers accounted for approximately 26% of revenues in 2018, which is a substantial risk in our view. Loss of any of these major customers can hurt top-line growth, which is a concern in our view.

IPG's significant exposure to the materials processing markets, dependency on few customers and substantial China exposure are likely to negatively impact financial performance.

- Moreover, the company generates a significant portion of its revenues (78.6% in 2019) from the International market. Hence, we anticipate adverse foreign currency exchange rates to impede revenue growth in the near term owing to fluctuation in the U.S. dollar as against the Chinese renminbi, Russian Ruble, the Euro and other foreign currencies.

- Further, we expect gross margin to contract going forward. Although gross margin has expanded in the last couple of years, we believe that unfavorable product mix – due to increasing percentage of lower margin high-power lasers – will hurt gross margin. Further, being a vertically integrated company – fixed costs – particularly related to direct labor is significantly high for IPG. This is a major headwind as the company may not be able to maneuver this fixed cost in case of a revenue shortfall.

- Moreover, the company is trading at premium in terms of Price/Sales (P/S). IPG Photonics currently has a trailing 12-month P/S ratio of 4.60. This level compares unfavorably with what the industry witnessed in the last year. Consequently, the valuation looks slightly stretched from P/S perspective.

Risks

- IPG is regarded as the pioneer and leader of the fiber lasers technology market. The company has a dominant position in the core material processing market on the back of its expertise in handling fiber lasers, which are more reliable, efficient, robust, compact and easier to operate than conventional lasers. Improvements in their output power levels and cost, as well as superior performance and lower cost of ownership have been driving the adoption of fiber-lasers. Management noted that use of high-strength steel and aluminum in automotive manufacturing and decreasing the weight of vehicles are driving the use of fiber lasers over other manufacturing methods such as stamping, non-laser welding, riveting and adhesives. Other trends, such as miniaturization of parts and electronics are driving adoption of lasers because no other tools can work as precisely. We believe that growing usage of fiber laser bodes well for IPG in the long run. Moreover, the company's strong IP base, which includes more than 350 patents issued and over 430 pending patent applications worldwide (as of Dec 31, 2018), is a key catalyst.

- IPG's vertically integrated business model is a key differentiator, in our view. This not only helps it to maintain technological lead but also keep costs of production significantly lower as evident from gross margin expansion over the three years. This has also aided the company to continue investments on product development. We also note that its research & development (R&D) expense in 2019 increased 5.9% over 2018. Despite this incremental investment, the company posts industry-leading operating margin. In the long term management forecasts gross margin in the range of 50–55% and operating margin in the range of 32–37% and aims to deliver double-digit revenue growth.

- Further, acquisitions have helped the company to expand its product portfolio. In November 2018, the company inked a deal to acquire privately held Genesis Systems Group (Genesis). The acquisition will help IPG to evolve as a provider of welding solutions and strategic partner to end customers. Notably, Genesis contributed $20 million in total revenues in third-quarter 2019. In 2016, the company acquired Menara Networks, which helped in expanding telecom product offering to include pluggable optical transceivers. The acquisitions of Innovative Laser Technologies (ILT) and OptiGrate Corp are positive. ILT offers precision laser systems, with a focus on the medical device industry. IPG management believes that the acquisition will strengthen presence in the medical vertical, simultaneously expanding ILT's addressable market into other verticals that require precision laser solutions. OptiGrate is a manufacturer of volume Bragg grating (VBG)-based filters and components. Bragg gratings are key components in all fiber lasers. OptiGrate's products enable performance improvement, miniaturization, and cost reduction of ultrafast pulsed lasers. The company supplies holographic optical elements to customers in optoelectronic, analytical, medical, defense, and other industries and also has strong clientele. The addition of OptiGrate is expected to assist the company easily develop the new ultrafast pulsed lasers.

- IPG is gradually expanding into new end-markets like advanced applications (3D Printing, Cinema, and micro-materials processing), communications and medical based on robust product portfolio and strong intellectual property (IP). IPG anticipates total addressable market (TAM) to hit $12 billion in 2023, from estimated figure of $10 billion in 2019, which presents significant growth prospects. IPG plans to expand the wavelengths at which its lasers currently operate in the near future. This includes UV, orange, red, green lasers and mid-infrared lasers for fine and micro processing, projection as well as other novel applications. IPG is in the process of developing pulsed fiber lasers with ultra-short pulse durations, pulsed and QCW lasers with high peak powers and mid infra-red lasers. The company also reported first-sales of its RGB laser, which is now used in cinemas by its OEM partner. Moreover, the company is developing new medical applications using fiber lasers for urological and dental procedures. The expansion into new end-markets will eventually lower exposure to the core material processing market, which is positive for investors over the long term.

Last Earnings Report

IPG Photonics Posts Q4 Loss, Revenues Decline Y/Y

Quarter Ending	12/2019
Report Date	Feb 13, 2020
Sales Surprise	6.92%
EPS Surprise	16.67%
Quarterly EPS	0.91
Annual EPS (TTM)	4.43

IPG Photonics Corporation reported fourth-quarter 2019 loss of 8 cents per share, against the year-ago quarter's reported earnings of $1.40 per share.

Unfavorable foreign-exchange movement, higher inventory, and impairment charges pertaining to restructuring, goodwill and other assets, weighed on the bottom line by 99 cents.

Revenues of $306.6 million fell 7.1% on a year-over-year basis. Unfavorable foreign-exchange movement offset revenues by $2 million.

Uncertainty in macroeconomic environment and geopolitical factors reduced demand for high-power CW lasers across China and Europe, which impacted the fourth-quarter revenues. However, Genesis acquisition contributed $19 million in total revenues in the reported quarter.

Revenues by Application

Materials processing (90.1% of total revenues) declined 10.5% year over year to $276.3 million.

Revenues from other applications (9.9%) improved 42.4% year over year to $30.4 million.

Revenues by Geography

Sales in United States and other North America (representing 23.9% of total sales) improved 30.5% year over year to $80.9 million.

However, sales in Eastern Europe/CIS (18.7%) declined 19.5% from the year-ago quarter to $57.3 million. Moreover, sales in Germany (7.1%) slumped 10% from the year-ago quarter to $21.9 million.

Revenues from China (30.2%) fell 21% to $92.6 million. Sales in Japan (5.5%) declined 36.8% to $16.9 million year over year.

Sales in other Asia and Australia (approximately 10.4%) improved 15.4% year over year to $32 million.

Revenues from rest of the world (1.6%) soared 513.5% to $4.9 million.

Revenues by Product Group

Sales of high-power CW lasers (51.3% of total revenues) were down 15.2% from the year-ago quarter to $157.4 million, primarily owing to weaker-than-expected demand in China and Europe, and decline in ASPs (or average selling price).

However, management noted that sales of 6 kilowatt or greater high power CW lasers represented 50% of all high power CW laser sales. Specifically, sales of 10 kilowatts or greater high power CW lasers improved 30% on a year-over-year basis.

Medium-power CW laser sales (4.5%) slumped 32.4% year over year to $13.7 million. Further, Pulsed lasers sales (10.3%) of $31.6 million declined 32.5% year over year.

However, QCW lasers sales (4.5%) improved almost 14% year over year to $13.8 million.

Moreover, Laser and Non-Laser system sales (12%) of $36.7 million surged 68.9% from the year-ago reported figure, primarily driven by synergies from Genesis acquisition.

Other revenues (17.4%), which include amplifiers, accessories, service, and parts, came in at $53.4 million, up 22.8% year over year.

Operating Details

IPG Photonics reported gross margin of 40.5%, declining from 50.5% reported in the year-ago quarter. This can be attributed to higher manufacturing cost and lower revenue base.

As a percentage of revenues, operating expenses expanded from 21.4% in the year-ago quarter to 40.4%, primarily owing to higher investments in sales, engineering and administrative expenses.

Consequently, operating margin contracted from 29.1% reported in the year-ago quarter to 0.1%.

Balance Sheet & Cash Flow

As of Dec 31, 2019, IPG Photonics had $1.18 billion in cash & cash equivalents and short-term investments compared with $1.08 billion reported in the previous quarter.

Total debt (including current portion) came in at $41.7 million, down from $42.6 million in the prior quarter.

The company generated $129.9 million in cash flow from operations compared with the previous quarter's reported figure of $91.8 million.

The company repurchased stock worth $15 million during the fourth quarter.

Guidance for Q1

For first-quarter 2020, IPG Photonics anticipates sales in the range of $220-$250 million.

Earnings are projected between break-even to 30 cents per share.

Management noted that the guidance takes into account the negative impact from the coronavirus outbreak. The company has reduced revenue guidance by $45 million and earnings by 45 cents owing to the coronavirus outbreak.

Recent News

On **Mar 5, 2020**, IPG Photonics unveiled support for bi-directional, single fiber transmission in order to strengthen coherent modules portfolio. Further, the company mentioned about the extension of temperature operations in its Hytham line of coherent transceiver modules branded Menara.

Valuation

IPG Photonics' shares are down 21.1% in the year-to-date period, and 30.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are down 19% and 11.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 19.9% and 1.6%, respectively.

The S&P 500 index is down 17.2% in the year-to-date period and 7.6% in the past year.

The stock is currently trading at 34.19X forward 12-month earnings, which compares to 19.76X for the Zacks sub-industry, 19.69X for the Zacks sector and 16.91X for the S&P 500 index.

Over the past five years, the stock has traded as high as 41.28X and as low as 14.25X, with a 5-year median of 21.07X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our $97 price target reflects 29.04X forward 12-month earnings.

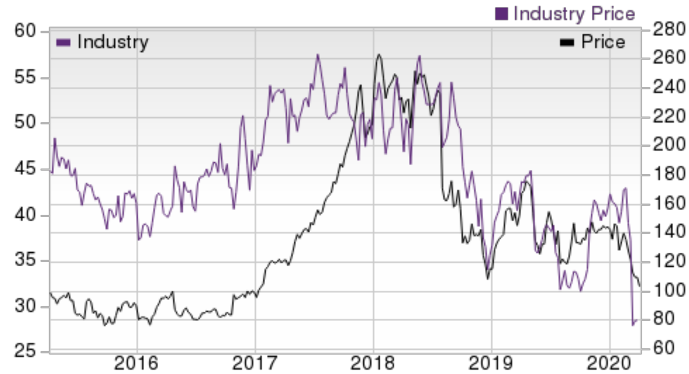
The table below shows summary valuation data for IPGP

Valuation Multiples - IPGP

		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	34.19	19.76	19.69	16.91
	5-Year High	41.28	29.4	21.91	19.34
	5-Year Low	14.25	14.09	16.71	15.19
	5-Year Median	21.07	19.89	19.21	17.44
P/S F12M	Current	4.89	4.03	3.11	2.92
	5-Year High	9.21	5.83	3.58	3.44
	5-Year Low	3.77	2.1	2.32	2.54
	5-Year Median	5.27	3.84	3.09	3
EV/Sales TTM	Current	3.75	4.02	3.55	2.65
	5-Year High	9.26	6.73	4.44	3.46
	5-Year Low	3.09	2.28	2.57	2.16
	5-Year Median	4.80	4.08	3.55	2.83

As of 04/07/2020

Industry Analysis **Zacks Industry Rank:** Top 36% (91 out of 253)



Top Peers

Coherent, Inc. **(COHR)**	Outperform
Cutera, Inc. **(CUTR)**	Neutral
II-VI Incorporated **(IIVI)**	Neutral
IRIDEX Corporation **(IRIX)**	Neutral
nLight Inc. **(LASR)**	Neutral
Lumentum Holdings Inc. **(LITE)**	Neutral
MKS Instruments, Inc. **(MKSI)**	Neutral
Microvision, Inc. **(MVIS)**	Neutral

Industry Comparison Industry: Lasers Systems And Components

Industry Peers

	IPGP Underperform	X Industry	S&P 500	COHR Outperform	LASR Neutral	LITE Neutral
VGM Score	F	-	-	C	F	A
Market Cap	6.07 B	28.82 M	18.38 B	2.57 B	464.19 M	5.59 B
# of Analysts	5	3.5	13	3	4	9
Dividend Yield	0.00%	0.00%	2.31%	0.00%	0.00%	0.00%
Value Score	F	-	-	C	F	C
Cash/Price	0.22	0.16	0.06	0.16	0.33	0.26
EV/EBITDA	12.89	3.13	11.23	13.07	1,825.99	23.20
PEG Ratio	5.59	5.46	1.91	NA	NA	0.80
Price/Book (P/B)	2.53	2.53	2.45	1.97	2.11	3.33
Price/Cash Flow (P/CF)	16.49	16.80	9.63	10.64	507.09	12.24
P/E (F1)	44.14	29.88	15.92	24.48	NA	14.41
Price/Sales (P/S)	4.62	2.00	1.94	1.88	2.63	3.20
Earnings Yield	2.31%	1.92%	6.15%	4.09%	-1.98%	6.93%
Debt/Equity	0.02	0.07	0.70	0.30	0.00	0.69
Cash Flow ($/share)	6.93	-0.01	7.01	10.00	0.02	6.12
Growth Score	F	-	-	C	F	A
Hist. EPS Growth (3-5 yrs)	9.49%	9.49%	10.92%	25.03%	NA	77.92%
Proj. EPS Growth (F1/F0)	-39.50%	38.00%	-0.12%	-26.52%	-891.67%	22.22%
Curr. Cash Flow Growth	-24.01%	-28.15%	5.93%	-46.32%	-94.94%	53.33%
Hist. Cash Flow Growth (3-5 yrs)	9.29%	10.12%	8.55%	18.56%	NA	53.13%
Current Ratio	9.88	2.08	1.24	4.38	7.93	6.19
Debt/Capital	1.56%	10.01%	42.36%	23.27%	0.00%	40.71%
Net Margin	13.71%	-0.86%	11.64%	1.76%	-7.29%	-0.19%
Return on Equity	10.09%	-1.64%	16.74%	6.46%	-3.94%	20.63%
Sales/Assets	0.49	1.16	0.54	0.63	0.70	0.60
Proj. Sales Growth (F1/F0)	-12.55%	0.00%	0.85%	-5.45%	8.40%	11.31%
Momentum Score	C	-	-	A	D	A
Daily Price Chg	0.35%	0.07%	0.69%	0.37%	16.12%	0.07%
1 Week Price Chg	-5.77%	-3.41%	-4.40%	-9.58%	-16.76%	-4.49%
4 Week Price Chg	-7.30%	-3.92%	-10.67%	-15.92%	-8.68%	-3.67%
12 Week Price Chg	-17.86%	-17.86%	-23.70%	-39.67%	-42.60%	-6.06%
52 Week Price Chg	-30.55%	-15.52%	-15.92%	-29.13%	-49.54%	26.76%
20 Day Average Volume	608,903	32,911	4,068,329	274,455	391,383	1,516,886
(F1) EPS Est 1 week change	-5.45%	0.00%	0.00%	0.00%	-2.69%	0.00%
(F1) EPS Est 4 week change	-9.22%	-5.48%	-5.24%	0.00%	-5.53%	-1.73%
(F1) EPS Est 12 week change	-42.09%	-5.72%	-6.86%	3.33%	-193.41%	5.64%
(Q1) EPS Est Mthly Chg	-11.16%	-8.83%	-8.25%	0.00%	-4.00%	-6.51%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	F
Momentum Score	C
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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