

IPG Photonics

Laser beam misses the mark - disappointing guide

Reiterate Rating: UNDERPERFORM | PO: 85.00 USD | Price: 86.99 USD

Weak Q4, disappointing start to 2024 – pressure persists

IPG Photonics (IPGP) shares fell 16% (vs SPX -1.4%) on yesterday's results. While Q4 results fell a bit short (EPS \$0.89 vs cons \$0.95, gross margin of 38% vs guide 41-43%), Q1 guidance disappointed: sales \$235-265mn (down 24-32% YoY), gross margin 37-40%, EPS \$0.30-0.60 (down 52-76% YoY and well below consensus of \$1.03). Given the weak demand backdrop, IPGP is focusing on lowering inventory levels through 1H24 (i.e., weighing on margins) and spending some opex to invest in the business. IPGP expects margin to recover in 2H as destocking pressures ease, demand stabilizes, and revenue gradually returns to growth on a YoY basis. Reiterate Underperform given persistent pressures.

Book to bill sub 1x: demand wanes across geographies

Book to bill was below 1x as increased economic uncertainty impacted industrial demand across the globe with large OEMs customers reducing purchases and working down inventories. In China, IPGP cited continued weakness due to lower demand, increased competition (cutting), and reduced investments in e-mobility. However, IPGP believes it's nearing a bottom of the demand cycle in China with 1Q bookings forecast flattening out in recent months (albeit down YoY basis). Weak PMIs (i.e., contraction territory) across North Am, Japan, and Europe continue to weigh on IPGP's growth in these geographies.

EV: positive long-term story yet faces n-term headwinds

EV-related sales account for ~20% of revenue and reached a record in 2023. That said, the large uptick in EV capacity in China in 2022 and 1H23 slowed down notably in 2H (utilization rates are low, industry waiting for a recovery before incremental capacity gets built out – a likely 2H24 event). Encouragingly, EV demand was positive outside China (NA, EU), offsetting industrial weakness. We plan to monitor recent headlines by OEMs (F, GM) around timeline of EV plant buildouts given the key theme for IPGP.

Underperform: recovery back to prior cycles to take time

We reduce our estimates post results. We lower our PO to \$85 (from \$91) based on 14x 2024 EV/EBITDA, as a higher multiple is warranted as we are closer to bottom of the EPS downgrade cycle (vs 10x prior). We reiterate Underperform – IPGP is one of the few names in our coverage reporting EPS below prior cycles given certain macro conditions (inventories, China, etc.) and could take longer than expected to return to those levels.

| Estimates (Dec) (US\$) | 2022A | 2023A | 2024E | 2025E | 2026E |
|---------------------------|-------|-------|--------|-------|-------|
| EPS | 5.02 | 4.63 | 3.65 | 4.25 | 4.85 |
| GAAP EPS | 2.19 | 4.63 | 3.65 | 4.25 | 4.85 |
| EPS Change (YoY) | -2.7% | -7.8% | -21.2% | 16.4% | 14.1% |
| Consensus EPS (Bloomberg) | | | 4.78 | 6.04 | 5.90 |
| DPS | 0 | 0 | 0 | 0 | 0 |
| Valuation (Dec) | | | | | |
| P/E | 17.3x | 18.8x | 23.8x | 20.5x | 17.9x |
| GAAP P/E | 39.7x | 18.8x | 23.8x | 20.5x | 17.9x |
| EV / EBITDA* | 13.5x | 11.6x | 14.5x | 11.9x | 10.6x |
| Free Cash Flow Yield* | 2.5% | 4.6% | 0.1% | 2.3% | 2.5% |

* For full definitions of *IQmethod*SM measures, see page 4.

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Timestamp: 14 February 2024 05:30AM EST

14 February 2024

Equity

Key Changes

| (US\$) | Previous | Current |
|---------------|----------|---------|
| Price Obj. | 91.00 | 85.00 |
| 2024E Rev (m) | 1,242.3 | 1,198.9 |
| 2025E Rev (m) | 1,329.4 | 1,266.4 |
| 2026E Rev (m) | NA | 1,356.0 |
| 2024E EPS | 4.60 | 3.65 |
| 2025E EPS | 5.35 | 4.25 |
| 2026E EPS | NA | 4.85 |

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Stock Data

| | |
|--------------------------------|------------------------|
| Price | 86.99 USD |
| Price Objective | 85.00 USD |
| Date Established | 14-Feb-2024 |
| Investment Opinion | B-3-9 |
| 52-Week Range | 83.00 USD - 141.85 USD |
| Mkt Val (mn) / Shares Out (mn) | 4,029 USD / 46.3 |
| Free Float | 60.5% |
| Average Daily Value (mn) | 26.57 USD |
| BofA Ticker / Exchange | IPGP / NAS |
| Bloomberg / Reuters | IPGP US / IPGP.OQ |
| ROE (2024E) | 6.7% |
| Net Dbt to Eqty (Dec-2023A) | -21.3% |
| ESGMeter TM | High |

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

North Am = North America, F = Ford, GM = General Motors, NA = North America, EU = Europe, EV = Electric Vehicle, PMI = Purchasing Manager Index

iQprofileSM IPG Photonics

iQmethodSM – Bus Performance*

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|----------------------------|-------|-------|-------|-------|-------|
| Return on Capital Employed | 4.1% | 8.8% | 6.5% | 7.1% | 7.5% |
| Return on Equity | 10.0% | 9.1% | 6.7% | 7.3% | 7.7% |
| Operating Margin | 11.9% | 18.0% | 14.5% | 18.0% | 19.5% |
| Free Cash Flow | 103 | 186 | 4 | 92 | 102 |

iQmethodSM – Quality of Earnings*

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|--------------------------|--------|--------|--------|--------|--------|
| Cash Realization Ratio | 0.8x | 1.4x | 0.9x | 1.1x | 1.0x |
| Asset Replacement Ratio | 1.2x | 1.6x | 2.1x | 1.9x | 1.9x |
| Tax Rate | 39.6% | 20.4% | 25.0% | 24.0% | 24.0% |
| Net Debt-to-Equity Ratio | -28.6% | -21.3% | -20.1% | -22.0% | -23.7% |
| Interest Cover | NA | NA | NA | NA | NA |

Income Statement Data (Dec)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|------------------------------|--------------|---------------|---------------|--------------|--------------|
| Sales | 1,430 | 1,287 | 1,199 | 1,266 | 1,356 |
| % Change | -2.1% | -9.9% | -6.9% | 5.6% | 7.1% |
| Gross Profit | 555 | 542 | 514 | 550 | 597 |
| % Change | -20.2% | -2.5% | -5.1% | 7.0% | 8.4% |
| EBITDA | 260 | 302 | 242 | 295 | 332 |
| % Change | -44.0% | 16.0% | -19.8% | 22.1% | 12.3% |
| Net Interest & Other Income | 14 | 43 | 50 | 30 | 30 |
| Net Income (Adjusted) | 256 | 219 | 168 | 196 | 223 |
| % Change | -8.2% | -14.3% | -23.3% | 16.5% | 14.2% |

Free Cash Flow Data (Dec)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|--|---------------|--------------|---------------|-----------|--------------|
| Net Income from Cont Operations (GAAP) | 112 | 219 | 168 | 196 | 223 |
| Depreciation & Amortization | 91 | 70 | 68 | 68 | 68 |
| Change in Working Capital | (454) | (251) | (197) | (108) | (63) |
| Deferred Taxation Charge | (28) | (14) | 0 | 0 | 0 |
| Other Adjustments, Net | 492 | 273 | 108 | 63 | 0 |
| Capital Expenditure | (110) | (110) | (143) | (127) | (126) |
| Free Cash Flow | 103 | 186 | 4 | 92 | 102 |
| % Change | -61.5% | 81.0% | -98.0% | NM | 11.3% |
| Share / Issue Repurchase | 6 | 3 | 0 | 0 | 0 |
| Cost of Dividends Paid | 0 | 0 | 0 | 0 | 0 |
| Change in Debt | (18) | (16) | 0 | 0 | 0 |

Balance Sheet Data (Dec)

| (US\$ Millions) | 2022A | 2023A | 2024E | 2025E | 2026E |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Cash & Equivalents | 698 | 515 | 518 | 610 | 713 |
| Trade Receivables | 211 | 219 | 204 | 219 | 241 |
| Other Current Assets | 1,077 | 1,181 | 1,272 | 1,303 | 1,343 |
| Property, Plant & Equipment | 581 | 602 | 677 | 736 | 794 |
| Other Non-Current Assets | 176 | 182 | 182 | 182 | 182 |
| Total Assets | 2,743 | 2,699 | 2,853 | 3,049 | 3,274 |
| Short-Term Debt | 16 | 0 | 0 | 0 | 0 |
| Other Current Liabilities | 259 | 215 | 201 | 202 | 203 |
| Long-Term Debt | 0 | 0 | 0 | 0 | 0 |
| Other Non-Current Liabilities | 83 | 69 | 69 | 69 | 69 |
| Total Liabilities | 358 | 284 | 270 | 271 | 272 |
| Total Equity | 2,385 | 2,415 | 2,583 | 2,779 | 3,002 |
| Total Equity & Liabilities | 2,743 | 2,699 | 2,853 | 3,049 | 3,274 |

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Industrial Machinery

Company Description

IPG Photonics is the largest vertically integrated manufacturer of fiber lasers with 65% share of the fiber laser market. IPGP is a best-in-class operator with sector leading profitability, free cash flow conversion, and market share. IPGP's lasers typically serve cutting and welding applications for general manufacturing, automotive, heavy industry, aerospace, and semi-conductor markets. China contributes 38% of sales, followed by Europe 25%, North America 20%, Japan 4% and Rest of World (11%).

Investment Rationale

IPG Photonics is well positioned to benefit from secular trends in the industrial laser market, as laser technology displaces traditional manufacturing processes. That said, we see risks in the near term given a slowdown in China (30% of last 12 months sales). While IPGP is likely to emerge with a higher quality mix of business over the long-term (EVs, welding, RoW vs China), our concern is the bridge to get there may not be linear and the return to peak earnings could take longer than expect.

Stock Data

Average Daily Volume 334,291

Quarterly Earnings Estimates

| | 2023 | 2024 |
|----|-------|-------|
| Q1 | 1.26A | 0.50E |
| Q2 | 1.31A | 0.97E |
| Q3 | 1.16A | 1.11E |
| Q4 | 0.89A | 1.08E |

Price objective basis & risk

IPG Photonics (IPGP)

We value IPGP at \$85 per share, based on 2024E EV/EBITDA of 14x, near the mid-point of the historical range (7-25x). In our view, the uncertainty around China, rising rate environment, shift in production footprint and escalating geopolitical risks are likely to constrain the multiple near-term. That said, we do not view the very low end of the range as appropriate given the long-term secular shift in on-shoring manufacturing processes and multi-year investments to build out EV battery manufacturing provide some valuation support.

Upside risks: 1) US-China trade tensions dissipate, 2) Stronger top-line growth over the next 2-3 years driven by higher conversion to laser technologies, 3) Better than expected execution on operating leverage, and 4) Quicker than expected adoption of fiber laser technology outside of industrial markets.

Downside risks: 1) Greenfield projects and capital investments continue to be pushed out to the right, 2) A bigger than expected downturn in automotive capex, 3) Intense pricing pressure from smaller competitors, and 4) Customers develop internal fiber laser technology quicker than expected.

Analyst Certification

I, Michael Feniger, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Machinery Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|-------------------|------------------------------|-------------|------------------|-------------------|
| BUY | | | | |
| | AECOM | ACM | ACM US | Michael Feniger |
| | Blue Bird Corp | BLBD | BLBD US | Sherif El-Sabbahy |
| | Caterpillar Inc | CAT | CAT US | Michael Feniger |
| | CNH Industrial NV | CNHI | CNHI US | Michael Feniger |
| | Construction Partners Inc. | ROAD | ROAD US | Michael Feniger |
| | ESAB Corp | ESAB | ESAB US | Sherif El-Sabbahy |
| | Finning International Inc. | YFTT | FTT CN | Sherif El-Sabbahy |
| | H&E Equipment Services Inc | HEES | HEES US | Sherif El-Sabbahy |
| | Knife River Corp | KNF | KNF US | Sherif El-Sabbahy |
| | Republic Services | RSG | RSG US | Michael Feniger |
| | Techtronic Industries Co Ltd | TTNDF | 669 HK | Michael Feniger |
| | Techtronic Industries Co Ltd | TTNDY | TTNDY US | Michael Feniger |
| | United Rentals Inc | URI | URI US | Michael Feniger |
| | Vulcan Materials | VMC | VMC US | Michael Feniger |
| | Waste Connections Inc | WCN | WCN US | Michael Feniger |
| | WillScot Mobile Mini | WSC | WSC US | Sherif El-Sabbahy |
| NEUTRAL | | | | |
| | AGCO Corp | AGCO | AGCO US | Michael Feniger |
| | Deere & Co | DE | DE US | Michael Feniger |
| | Fluor | FLR | FLR US | Michael Feniger |
| | GFL Environmental Inc | GFL | GFL US | Michael Feniger |
| | GFL Environmental Inc | YGFL | GFL CN | Michael Feniger |
| | Jacobs Eng. | J | J US | Michael Feniger |
| | Kennametal Inc. | KMT | KMT US | Michael Feniger |
| | Martin Marietta Materials | MLM | MLM US | Michael Feniger |
| | NV5 Global Inc. | NVEE | NVEE US | Michael Feniger |
| | PACCAR Inc | PCAR | PCAR US | Michael Feniger |
| | RB Global, Inc | RBA | RBA US | Michael Feniger |
| | Waste Management | WM | WM US | Michael Feniger |



US - Machinery Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|---------------------|------------------------------------|-------------|------------------|-------------------|
| UNDERPERFORM | | | | |
| | Allison Transmission Holdings Inc. | ALSN | ALSN US | Sherif El-Sabbahy |
| | Casella | CWST | CWST US | Michael Feniger |
| | Cummins Inc | CMI | CMI US | Michael Feniger |
| | Herc Holdings Inc | HRI | HRI US | Sherif El-Sabbahy |
| | IPG Photonics | IPGP | IPGP US | Michael Feniger |
| | Oshkosh Corp. | OSK | OSK US | Michael Feniger |
| | Terex Corp. | TEX | TEX US | Michael Feniger |
| | Timken Company | TKR | TKR US | Michael Feniger |

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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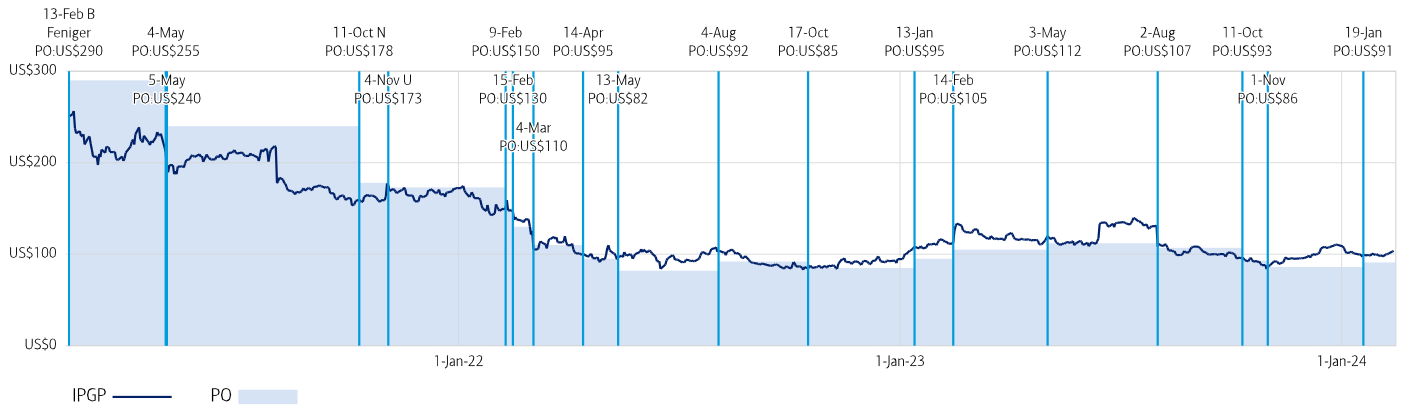
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IPG Photonics (IPGP) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Machinery/Diversified Manufacturing Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 27 | 42.19% | Buy | 8 | 29.63% |
| Hold | 17 | 26.56% | Hold | 8 | 47.06% |
| Sell | 20 | 31.25% | Sell | 8 | 40.00% |

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1895 | 53.62% | Buy | 1083 | 57.15% |
| Hold | 832 | 23.54% | Hold | 454 | 54.57% |
| Sell | 807 | 22.84% | Sell | 383 | 47.46% |

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster ^{R2} |
|-------------------|---|--|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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