

IPG PHOTONICS CORP
Form 10-Q
November 07, 2014
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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 September 30, 2014
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 04-3444218
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

50 Old Webster Road, 01540
Oxford, Massachusetts (Zip code)
(Address of principal executive offices)
(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

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 November 3, 2014, there were 52,182,177 shares of the registrant's common stock issued and outstanding.

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

| | September 30, 2014 | December 31, 2013 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------|----------------------|
| | (In thousands, except share and per share data) | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$487,518 | \$448,776 |
| Accounts receivable, net | 136,629 | 103,803 |
| Inventories | 179,476 | 172,700 |
| Prepaid income taxes and income taxes receivable | 20,940 | 15,996 |
| Prepaid expenses and other current assets | 23,464 | 30,836 |
| Deferred income taxes, net | 15,227 | 14,232 |
| Total current assets | 863,254 | 786,343 |
| PROPERTY, PLANT AND EQUIPMENT, NET | 271,286 | 252,245 |
| DEFERRED INCOME TAXES, NET | 9,674 | 4,799 |
| INTANGIBLE ASSETS, NET | 9,847 | 9,564 |
| GOODWILL | 455 | 455 |
| OTHER ASSETS | 30,872 | 7,810 |
| TOTAL | \$1,185,388 | \$1,061,216 |
| LIABILITIES AND EQUITY | | |
| CURRENT LIABILITIES: | | |
| Revolving line-of-credit facilities | \$2,276 | \$3,296 |
| Current portion of long-term debt | 11,667 | 1,333 |
| Accounts payable | 18,969 | 18,787 |
| Accrued expenses and other liabilities | 66,862 | 59,336 |
| Deferred income taxes, net | 3,151 | 2,109 |
| Income taxes payable | 25,088 | 15,218 |
| Total current liabilities | 128,013 | 100,079 |
| DEFERRED INCOME TAXES AND OTHER LONG-TERM LIABILITIES | 20,672 | 21,835 |
| LONG-TERM DEBT, NET OF CURRENT PORTION | — | 11,333 |
| Total liabilities | 148,685 | 133,247 |
| COMMITMENTS AND CONTINGENCIES (NOTE 12) | | |
| IPG PHOTONICS CORPORATION STOCKHOLDERS' EQUITY: | | |
| Common stock, \$0.0001 par value, 175,000,000 shares authorized; 52,168,371 shares issued and outstanding at September 30, 2014; 51,930,978 shares issued and outstanding at December 31, 2013 | 5 | 5 |
| Additional paid-in capital | 556,401 | 538,908 |
| Retained earnings | 534,771 | 390,757 |
| Accumulated other comprehensive loss | (54,474 |) (1,701 |
| Total IPG Photonics Corporation stockholders' equity | 1,036,703 | 927,969 |
| TOTAL | \$1,185,388 | \$1,061,216 |

See notes to consolidated financial statements.

Table of ContentsIPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------------------------------------|---------------------------------------|------------|------------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| | (in thousands, except per share data) | | | |
| NET SALES | \$ 199,651 | \$ 172,152 | \$ 562,430 | \$ 482,175 |
| COST OF SALES | 90,561 | 79,339 | 259,829 | 223,799 |
| GROSS PROFIT | 109,090 | 92,813 | 302,601 | 258,376 |
| OPERATING EXPENSES: | | | | |
| Sales and marketing | 7,496 | 6,801 | 22,708 | 19,514 |
| Research and development | 13,447 | 11,501 | 39,593 | 30,782 |
| General and administrative | 14,172 | 13,175 | 40,212 | 37,814 |
| (Gain) loss on foreign exchange | (3,614) | 1,563 | (4,039) | 972 |
| Total operating expenses | 31,501 | 33,040 | 98,474 | 89,082 |
| OPERATING INCOME | 77,589 | 59,773 | 204,127 | 169,294 |
| OTHER INCOME (EXPENSE), Net: | | | | |
| Interest (expense) income, net | (4) | 63 | (143) | (25) |
| Other income, net | 162 | 218 | 735 | 49 |
| Total other income (expense) | 158 | 281 | 592 | 24 |
| INCOME BEFORE PROVISION FOR INCOME TAXES | 77,747 | 60,054 | 204,719 | 169,318 |
| PROVISION FOR INCOME TAXES | (22,547) | (17,716) | (60,705) | (50,133) |
| NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION | \$ 55,200 | \$ 42,338 | \$ 144,014 | \$ 119,185 |
| NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION PER SHARE: | | | | |
| Basic | \$ 1.06 | \$ 0.82 | \$ 2.77 | \$ 2.32 |
| Diluted | \$ 1.05 | \$ 0.81 | \$ 2.73 | \$ 2.28 |
| WEIGHTED AVERAGE SHARES OUTSTANDING: | | | | |
| Basic | 52,088 | 51,495 | 52,060 | 51,474 |
| Diluted | 52,792 | 52,367 | 52,780 | 52,346 |
| See notes to consolidated financial statements. | | | | |

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------------------------------------------|----------------------------------------|----------|------------------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| | (In thousands) | | | |
| Net income | \$55,200 | \$42,338 | \$144,014 | \$119,185 |
| Other comprehensive income, net of tax: | | | | |
| Translation adjustments | (46,918) | 11,892 | (52,901) | (2,094) |
| Unrealized gain on derivatives | 45 | 53 | 128 | 227 |
| Total other comprehensive (loss) income | (46,873) | 11,945 | (52,773) | (1,867) |
| Comprehensive income attributable to IPG Photonics Corporation | \$8,327 | \$54,283 | \$91,241 | \$117,318 |
| See notes to consolidated financial statements. | | | | |

Table of ContentsIPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine Months Ended September 30, | |
|-------------------------------------------------------------------------------------|------------------------------------|------------|
| | 2014 | 2013 |
| | (In thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 144,014 | \$ 119,185 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 26,409 | 23,414 |
| Deferred income taxes | (5,954) | (7,591) |
| Stock-based compensation | 11,067 | 8,604 |
| Unrealized (gain) loss on foreign currency transactions | (4,547) | 972 |
| Other | 464 | 369 |
| Provisions for inventory, warranty & bad debt | 19,906 | 18,203 |
| Changes in assets and liabilities that (used) provided cash: | | |
| Accounts receivable | (37,926) | (26,942) |
| Inventories | (30,220) | (43,705) |
| Prepaid expenses and other current assets | 202 | (3,478) |
| Accounts payable | 1,324 | (2,008) |
| Accrued expenses and other liabilities | 2,653 | 2,734 |
| Income and other taxes payable | (609) | (25,186) |
| Tax benefit from exercise of employee stock options | (2,696) | (3,610) |
| Net cash provided by operating activities | 124,087 | 60,961 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of and deposits on property, plant and equipment | (72,723) | (48,333) |
| Purchase of intangible assets | (2,000) | — |
| Proceeds from sales of property, plant and equipment | 418 | 202 |
| Acquisition of businesses | — | (5,555) |
| Other | 66 | 442 |
| Net cash used in investing activities | (74,239) | (53,244) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from line-of-credit facilities | 26,051 | 14,124 |
| Payments on line-of-credit facilities | (26,836) | (15,019) |
| Principal payments on long-term borrowings | (1,000) | (2,519) |
| Exercise of employee stock options and issuances under employee stock purchase plan | 3,730 | 3,228 |
| Tax benefit from exercise of employee stock options | 2,696 | 3,610 |
| Net cash provided by financing activities | 4,641 | 3,424 |
| EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS | (15,747) | 3,161 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 38,742 | 14,302 |
| CASH AND CASH EQUIVALENTS — Beginning of period | 448,776 | 384,053 |
| CASH AND CASH EQUIVALENTS — End of period | \$ 487,518 | \$ 398,355 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | \$ 302 | \$ 190 |
| Cash paid for income taxes | \$ 56,730 | \$ 74,107 |
| Non-cash transactions: | | |
| Demonstration units transferred from inventory to other assets | \$ 2,649 | \$ 3,185 |
| Inventory transferred to machinery and equipment | \$ 1,303 | \$ — |

| | | |
|-------------------------------------------------------------------------|----------|--------|
| Additions to property, plant and equipment included in accounts payable | \$ 1,959 | \$ 679 |
|-------------------------------------------------------------------------|----------|--------|

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF EQUITY

| | Nine Months Ended September 30, | | | |
|-----------------------------------------------------------------|-------------------------------------------------|-------------|------------|-----------|
| | 2014 | | 2013 | |
| | (In thousands, except share and per share data) | | | |
| | Shares | Amount | Shares | Amount |
| COMMON STOCK | | | | |
| Balance, beginning of year | 51,930,978 | \$5 | 51,359,247 | \$5 |
| Exercise of stock options | 219,875 | — | 231,408 | — |
| Common stock issued under employee stock purchase plan | 17,518 | — | 13,913 | — |
| Balance, end of period | 52,168,371 | 5 | 51,604,568 | 5 |
| ADDITIONAL PAID-IN CAPITAL | | | | |
| Balance, beginning of year | | 538,908 | | 511,039 |
| Stock-based compensation | | 11,067 | | 8,604 |
| Exercise of stock options and related tax benefit from exercise | | 5,402 | | 6,120 |
| Common stock issued under employee stock purchase plan | | 1,024 | | 718 |
| Balance, end of period | | 556,401 | | 526,481 |
| RETAINED EARNINGS | | | | |
| Balance, beginning of year | | 390,757 | | 234,977 |
| Net income attributable to IPG Photonics Corporation | | 144,014 | | 119,185 |
| Balance, end of period | | 534,771 | | 354,162 |
| ACCUMULATED OTHER COMPREHENSIVE LOSS | | | | |
| Balance, beginning of year | | (1,701) | | (3,094) |
| Translation adjustments | | (52,901) | | (2,094) |
| Unrealized gain on derivatives, net of tax | | 128 | | 227 |
| Balance, end of period | | (54,474) | | (4,961) |
| TOTAL IPG PHOTONICS CORPORATION | | | | |
| STOCKHOLDERS' EQUITY | | \$1,036,703 | | \$875,687 |
| See notes to consolidated financial statements. | | | | |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by IPG Photonics Corporation, or "IPG", "we", "our", "its" or the "Company". Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The consolidated financial statements include the Company's accounts and those of its 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 the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

In the opinion of the Company's management, the unaudited financial information for the interim periods presented reflects all adjustments necessary for a fair presentation of the Company's 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.

The Company has evaluated subsequent events through the time of filing this Quarterly Report on Form 10-Q with the SEC.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require

adoption until a future date are not expected to have a material impact on the Company's financial statements upon adoption.

3. INVENTORIES

Inventories consist of the following:

| | September 30, 2014 | December 31, 2013 |
|------------------------------|-----------------------|----------------------|
| Components and raw materials | \$58,172 | \$54,539 |
| Work-in-process | 63,823 | 64,927 |
| Finished goods | 57,481 | 53,234 |
| Total | \$179,476 | \$172,700 |

The Company recorded inventory provisions totaling \$2,551 and \$4,286 for the three months ended September 30, 2014 and 2013, respectively, and \$8,363 and \$7,842 for the nine months ended September 30, 2014 and 2013, respectively. These provisions relate 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.

4. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities consist of the following:

| | September 30, 2014 | December 31, 2013 |
|----------------------------------------|-----------------------|----------------------|
| Accrued compensation | \$29,626 | \$25,727 |
| Customer deposits and deferred revenue | 21,504 | 18,489 |
| Current portion of accrued warranty | 7,948 | 7,724 |
| Other | 7,784 | 7,396 |
| Total | \$66,862 | \$59,336 |

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(In thousands, except share and per share data)

5. FINANCING ARRANGEMENTS

The Company's borrowings under existing financing arrangements consist of the following:

| | September 30, 2014 | December 31, 2013 |
|--------------------------------------|-----------------------|----------------------|
| Revolving line-of-credit facilities: | | |
| European overdraft facilities | \$2,276 | \$1,038 |
| Euro line of credit | — | 2,258 |
| Total | \$2,276 | \$3,296 |
| Term debt: | | |
| U.S. long-term note | \$11,667 | \$12,666 |
| Less: current portion | (11,667) | (1,333) |
| Total long-term debt | \$— | \$11,333 |

The U.S. and Euro lines of credit are available to certain foreign subsidiaries and allow for borrowings in the local currencies of those subsidiaries. There were no drawings on the U.S. line of credit at September 30, 2014 or December 31, 2013. At September 30, 2014, there were no amounts drawn on the Euro line of credit, however, there were \$1.9 million of guarantees issued against the line which reduces total availability.

As of September 30, 2014, the remaining balance of the U.S. long-term note outstanding is considered current because the term of the note expires in June 2015 and is thus due within one year.

6. 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:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------------------------------------------------|----------------------------------------|----------|------------------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income attributable to IPG Photonics Corporation | \$55,200 | \$42,338 | \$144,014 | \$119,185 |
| Weighted average shares | 52,088 | 51,495 | 52,060 | 51,474 |
| Dilutive effect of common stock equivalents | 704 | 872 | 720 | 872 |
| Diluted weighted average common shares | 52,792 | 52,367 | 52,780 | 52,346 |
| Basic net income attributable to IPG Photonics Corporation per share | \$1.06 | \$0.82 | \$2.77 | \$2.32 |
| Diluted net income attributable to IPG Photonics Corporation per share | \$1.05 | \$0.81 | \$2.73 | \$2.28 |

The computation of diluted weighted average common shares excludes options to purchase 30,000 shares and 31,000 shares for the three months ended September 30, 2014 and 2013, respectively, and 61,000 shares and 210,000 shares for the nine months ended September 30, 2014 and 2013, respectively, because the effect would be anti-dilutive.

7. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative instruments – The Company's primary market exposures are to interest rates and foreign exchange rates. The Company uses certain derivative financial instruments to help manage these exposures. The Company executes these instruments with financial institutions it judges to be credit-worthy. The Company does not hold or issue derivative financial instruments for trading or speculative purposes.

The Company recognizes all derivative financial instruments as either assets or liabilities at fair value in the consolidated balance sheets. The Company has an interest rate swap that is classified as a cash flow hedge of its variable rate debt. The Company has no derivatives that are not accounted for as a hedging instrument.

Cash flow hedges – The Company's cash flow hedge is an interest rate swap under which it pays fixed rates of interest. The fair value amounts in the consolidated balance sheet related to the interest rate swap were:

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(In thousands, except share and per share data)

| Notional Amounts ¹ | | Other Assets | | Other Current Liabilities ² | | Other Long-Term Liabilities ² | |
|-------------------------------|-------------------|--------------------|-------------------|----------------------------------------|-------------------|------------------------------------------|-------------------|
| September 30, 2014 | December 31, 2013 | September 30, 2014 | December 31, 2013 | September 30, 2014 | December 31, 2013 | September 30, 2014 | December 31, 2013 |
| \$ 11,667 | \$ 12,666 | \$ — | \$ — | \$ 221 | \$ — | \$ — | \$ 423 |

(1) Notional amounts represent the gross contract/notional amount of the derivatives outstanding.

(2) As of September 30, 2014, the remaining balance of the U.S. long-term note outstanding is considered current because the term of the note expires in June 2015 and is thus due within one year. Accordingly, the interest rate swap liability has been reclassified.

The derivative gains and losses in the consolidated statements of income related to the Company's interest rate swap contracts were as follows:

| | Three Months Ended September 30, 2014 | | Nine Months Ended September 30, 2014 | |
|-------------------------------------------------------------------------------------------|---------------------------------------|----------|--------------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Effective portion recognized in other comprehensive loss, pretax: | | | | |
| Interest rate swap | \$ 145 | \$ 186 | \$ 427 | \$ 733 |
| Effective portion reclassified from other comprehensive loss to interest expense, pretax: | | | | |
| Interest rate swap | \$(73) | \$(101) | \$(225) | \$(371) |
| Ineffective portion recognized in income: | | | | |
| Interest rate swap | \$ — | \$ — | \$ — | \$ — |

8. FAIR VALUE MEASUREMENTS

The Company's financial instruments consist of cash equivalents, accounts receivable, auction rate securities, accounts payable, drawings on revolving lines of credit, long-term debt and certain derivative instruments.

The valuation techniques used to measure fair value are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect internal market assumptions. These two types of inputs create the following fair value hierarchy: Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The carrying amounts of cash equivalents, accounts receivable, accounts payable and drawings on revolving lines of credit are considered reasonable estimates of their fair market value, due to the short maturity of these instruments or as a result of the competitive market interest rates, which have been negotiated. If measured at fair value, accounts receivable and accounts payable would be classified as Level 3 and drawings on the revolving lines of credit would be classified as Level 2.

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(In thousands, except share and per share data)

The following table presents information about the Company's assets and liabilities measured at fair value:

| | Total | Fair Value Measurements at September 30, 2014 | | |
|-----------------------------------|-----------|-----------------------------------------------|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Assets | | | | |
| Cash equivalents | \$237,390 | \$237,390 | \$— | \$— |
| Auction rate securities | 1,126 | — | — | 1,126 |
| Total assets | \$238,516 | \$237,390 | \$— | \$1,126 |
| Liabilities | | | | |
| Contingent purchase consideration | \$98 | \$— | \$— | \$98 |
| Interest rate swaps | 221 | — | 221 | — |
| Total liabilities | \$319 | \$— | \$221 | \$98 |

| | Total | Fair Value Measurements at December 31, 2013 | | |
|-----------------------------------|-----------|----------------------------------------------|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Assets | | | | |
| Cash equivalents | \$240,159 | \$240,159 | \$— | \$— |
| Auction rate securities | 1,120 | — | — | 1,120 |
| Total assets | \$241,279 | \$240,159 | \$— | \$1,120 |
| Liabilities | | | | |
| Contingent purchase consideration | \$375 | \$— | \$— | \$375 |
| Interest rate swaps | 423 | — | 423 | — |
| Total liabilities | \$798 | \$— | \$423 | \$375 |

The fair value of the auction rate securities considered prices observed in inactive secondary markets for the securities held by the Company.

The fair value of accrued contingent consideration incurred was determined using an income approach at the acquisition date and reporting date. That approach is based on significant inputs that are not observable in the market. Key assumptions include assessing the probability of meeting certain milestones required to earn the contingent consideration.

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------------------|--------------------|---------|-------------------|---------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Auction Rate Securities | | | | |
| Balance, beginning of period | \$1,124 | \$1,116 | \$1,120 | \$1,112 |
| Change in fair value and accretion | 2 | 2 | 6 | 6 |
| Balance, end of period | \$1,126 | \$1,118 | \$1,126 | \$1,118 |
| Contingent Purchase Consideration | | | | |
| Balance, beginning of period | \$357 | \$559 | \$375 | \$3,023 |
| Change in fair value and currency fluctuations | (259) | (184) | (277) | (2,648) |
| Balance, end of period | \$98 | \$375 | \$98 | \$375 |

9. GOODWILL AND INTANGIBLES

The carrying amount of goodwill was \$455 at both December 31, 2013 and September 30, 2014.

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(In thousands, except share and per share data)

Intangible assets, subject to amortization, consisted of the following:

| | September 30, 2014 | | | | December 31, 2013 | | | |
|-------------------------------------|-----------------------|--------------------------|---------------------|------------------------|-----------------------|--------------------------|---------------------|------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted-Average Lives | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted-Average Lives |
| Patents | \$6,642 | \$ (4,124) | \$2,518 | 6 Years | \$4,667 | \$ (4,091) | \$576 | 6 Years |
| Customer relationships | 3,828 | (3,376) | 452 | 5 Years | 4,112 | (3,324) | 788 | 5 Years |
| Production know-how | 6,918 | (2,427) | 4,491 | 8 Years | 7,063 | (1,747) | 5,316 | 8 Years |
| Technology, trademark and tradename | 4,175 | (1,789) | 2,386 | 8 Years | 4,271 | (1,387) | 2,884 | 8 Years |
| | \$21,563 | \$ (11,716) | \$9,847 | | \$20,113 | \$ (10,549) | \$9,564 | |

During the third quarter of 2014, the Company purchased certain patents and patent rights in the amount of \$2,000. Amortization expense for the three months ended September 30, 2014 and 2013 was \$527 and \$596, respectively. Amortization expense for the nine months ended September 30, 2014 and 2013 was \$1,604 and \$1,705, respectively. The estimated future amortization expense for intangibles for the remainder of 2014 and subsequent years is as follows:

| 2014 | 2015 | 2016 | 2017 | 2018 | Thereafter | Total |
|-------|---------|---------|---------|---------|------------|---------|
| \$518 | \$1,527 | \$1,439 | \$1,439 | \$1,375 | \$3,549 | \$9,847 |

10. PRODUCT WARRANTIES

The Company typically provides one to three-year parts and service warranties on lasers and amplifiers. Most of the Company's sales offices provide support to customers in their respective geographic areas. Warranty reserves have generally been sufficient to cover product warranty repair and replacement costs. The following table summarizes product warranty activity recorded during the nine months ended September 30, 2014 and 2013.

| | 2014 | 2013 |
|--------------------------------------|----------|----------|
| Balance at January 1 | \$14,997 | \$10,714 |
| Provision for warranty accrual | 10,460 | 7,867 |
| Warranty claims and other reductions | (7,195) | (4,977) |
| Foreign currency translation | (1,183) | 136 |
| Balance at September 30 | \$17,079 | \$13,740 |

Accrued warranty reported in the accompanying consolidated financial statements as of September 30, 2014 and December 31, 2013 consist of \$7,948 and \$7,724 in accrued expenses and other liabilities and \$9,131 and \$7,273 in other long-term liabilities, respectively.

11. INCOME TAXES

A reconciliation of the total amounts of unrecognized tax benefits is as follows:

| | 2014 | 2013 |
|------------------------------------------------------------|---------|---------|
| Balance at January 1 | \$6,501 | \$5,392 |
| Reductions of prior period positions | — | (63) |
| Additions for tax positions in prior period | — | — |
| (Reductions) additions for tax positions in current period | (795) | 293 |
| Balance at September 30 | \$5,706 | \$5,622 |

Substantially all of the liability for uncertain tax benefits related to various federal, state and foreign income tax matters, would benefit the Company's effective tax rate, if recognized.

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(In thousands, except share and per share data)

12. COMMITMENTS AND CONTINGENCIES

From time to time, the Company may be involved in disputes and legal proceedings in the ordinary course of its business.

These proceedings may include allegations of infringement of intellectual property, commercial disputes and employment

matters. As of September 30, 2014 and through the filing date of these Financial Statements, the Company has no legal proceedings ongoing that management estimates could have a material effect on the Company's Consolidated Financial Statements.

Russia/Ukraine

Recent events in Ukraine have resulted in the United States and the European Union imposing and escalating sanctions on Russia and certain businesses, sectors and individuals in Russia. The United States and the European Union also suspended the granting of certain types of export licenses to Russia. Russia has imposed its own sanctions on certain individuals in the U.S. and may be considering other sanctions on the U.S. and the European Union or certain businesses or individuals from them. The Company has a large manufacturing facility and research and development operations in Russia which supplies components to its U.S. and German manufacturing facilities and finished lasers to the Company's subsidiary in China. In addition, the Company supplies components from its U.S. and German manufacturing facilities to its Russian facility. To date, the Company has not experienced any material disruptions or impact from current sanctions. Should there be disruption of the Company's supplies from or to its Russian operations, or should the United States, the European Union or Russia implement different sanctions, the Company's production and/or deliveries as well as results of operations would be affected.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward looking statements that are based on management's current expectations, estimates and projections about our business and operations. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements. See "Cautionary Statement Regarding Forward-Looking Statements."

Overview

We develop and manufacture a broad line of high-performance fiber lasers, fiber amplifiers and diode lasers that are used in numerous applications, primarily in materials processing. We sell our products globally to original equipment manufacturers ("OEMs"), system integrators and end users. We market our products internationally primarily through our direct sales force.

We are vertically integrated such that we design and manufacture most of our key components used in our finished products, from semiconductor diodes to optical fiber preforms, finished fiber lasers and amplifiers. We also manufacture certain complementary products used with our lasers, including optical delivery cables, fiber couplers, beam switches, optical heads and chillers. In addition, we offer laser-based systems for certain markets and applications.

Factors and Trends That Affect Our Operations and Financial Results

In reading our financial statements, you should be aware of the following factors and trends that our management believes are important in understanding our financial performance.

Net sales. We derive net sales primarily from the sale of fiber lasers and amplifiers. We also sell diode lasers, communications systems, laser systems and complementary products. We sell our products through our direct sales organization and our network of distributors and sales representatives, as well as system integrators. We sell our products to OEMs that supply materials processing laser systems, communications systems and medical laser systems to end users. We also sell our products to end users that build their own systems which incorporate our products or use our products as an energy or light source. Our scientists and engineers work closely with OEMs, systems integrators and end users to analyze their system requirements and match appropriate fiber laser or amplifier specifications. Our sales cycle varies substantially. If an OEM has qualified our product for use in their systems or for a certain application the sales cycle will depend upon the end demand for their products and our manufacturing lead times. For other customers, the sales cycle can range from a period of a few weeks to as long as one year or more, but is typically several months.

Sales of our products generally are recognized upon shipment, provided that no obligations remain and collection of the receivable is reasonably assured. Our sales typically are made on a purchase order basis rather than through long-term purchase commitments.

We develop our products to standard specifications and use a common set of components within our product architectures. Our major products are based upon a common technology platform. We continually enhance these and other products by improving their components and developing new components and new product designs.

The average selling prices of our products generally decrease as the products mature. These decreases result from factors such as decreased manufacturing costs and increases in unit volumes, increased competition, the introduction of new products and market share considerations. In the past, we have lowered our selling prices in order to penetrate new markets and applications. Furthermore, we may negotiate discounted selling prices from time to time with certain customers that purchase multiple units.

Gross margin. Our total gross margin in any period can be significantly affected by total net sales in any period, by product mix, that is, the percentage of our revenue in the period that is attributable to higher or lower-power products and by other factors, some of which are not under our control.

Our product mix affects our margins because the selling price per watt, based on the average output power of a laser, is generally higher for low and mid-power devices, high-power pulsed lasers and certain specialty products than for high-power devices and low-power pulsed lasers sold in large volumes. The overall cost of high-power lasers may be

partially offset by improved absorption of fixed overhead costs associated with sales of larger volumes of higher-power products because they use a greater number of optical components and drive economies of scale in manufacturing. Also, the profit margins on systems can be lower than margins for our laser and amplifier sources, depending on the configuration, volume and competitive forces, among other factors.

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A high proportion of our costs is fixed so they are generally difficult or slow to adjust in response to changes in demand. In addition, our fixed costs increase as we expand our capacity. Gross margins generally decline if production volumes are lower as a result of a decrease in sales or a reduction in inventory because the absorption of fixed manufacturing costs will be reduced. Gross margins generally improve when the opposite occurs. If both sales and inventory decrease in the same period, the decline in gross margin may be greater if we cannot reduce fixed costs or choose not to reduce fixed costs to match the decrease in the level of production. If we experience a decline in sales that reduces absorption of our fixed costs, or if we have production issues or inventory write-downs, our gross margins will be negatively affected.

We also regularly review our inventory for items that are slow-moving, have been rendered obsolete or determined to be excess. Any write-off of such slow-moving, obsolete or excess inventory affects our gross margins. For example, we recorded provisions for inventory totaling \$2.6 million and \$4.3 million for the three months ended September 30, 2014 and 2013, respectively, and \$8.4 million and \$7.8 million for the nine months ended September 30, 2014 and 2013, respectively and \$15.1 million, \$8.2 million and \$6.1 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Sales and marketing expense. We expect to continue to expand our worldwide direct sales organization, build and expand applications centers, hire additional personnel involved in marketing in our existing and new geographic locations, increase the number of units for demonstration purposes and otherwise increase expenditures on sales and marketing activities in order to support the growth in our net sales. As such, we expect that our sales and marketing expenses will increase in the aggregate.

Research and development expense. We plan to continue to invest in research and development to improve our existing components and products and develop new components, products and systems. The amount of research and development expense we incur may vary from period to period. In general, if net sales continue to increase we expect research and development expense to increase in the aggregate.

General and administrative expense. We expect our general and administrative expenses to increase as we continue to invest in systems and resources to support our worldwide operations. Legal expenses vary from quarter to quarter based primarily upon the timing and level of litigation and transaction activities.

Major customers. While we have historically depended on a few customers for a large percentage of our annual net sales, the composition of this group can change from year to year. Net sales derived from our five largest customers as a percentage of our net sales was 24% for the nine months ended September 30, 2014 and 21%, 16% and 17% for the full years 2013, 2012 and 2011, respectively. Our largest customer accounted for 12% of our net sales for the nine months ended September 30, 2014. We seek to add new customers and to expand our relationships with existing customers. We anticipate that the composition of our significant customers will continue to change. If any of our significant customers substantially reduced their purchases from us, our results would be adversely affected.

Results of Operations for the three months ended September 30, 2014 compared to the three months ended September 30, 2013

Net sales. Net sales increased by \$27.5 million, or 16.0%, to \$199.7 million for the three months ended September 30, 2014 from \$172.2 million for the three months ended September 30, 2013.

| | Three Months Ended September 30, | | | | Change | | | |
|----------------------|----------------------------------|------------|-------------|------------|------------|--------|----|--|
| | 2014 | % of Total | 2013 | % of Total | | | | |
| Materials processing | \$192,288 | 96.3 | % \$164,101 | 95.3 | % \$28,187 | 17.2 | % | |
| Other applications | 7,363 | 3.7 | % 8,051 | 4.7 | % (688 |) (8.5 |)% | |
| Total | \$199,651 | 100.0 | % \$172,152 | 100.0 | % \$27,499 | 16.0 | % | |

Sales for materials processing applications increased due to higher sales across our product lines including high-power, medium-power, QCW and pulsed lasers. We continue to see increased acceptance of the advantages of fiber laser technology. A growing number of OEM customers have developed cutting systems that use our high-power lasers and sales of these systems are increasing by displacing gas lasers in systems sold by our OEM customers. QCW laser sales increased due to continued acceptance and by displacing Nd:YAG lasers in applications such as

fine-welding and hole drilling as well as penetrating new applications. Medium-power lasers sales increased due to underlying growth in laser sintering and 3D manufacturing applications and continued adoption for fine welding applications. The increase in sales of pulsed lasers used for marking and engraving applications is due to the timing of underlying consumer electronics demand and the introduction of the new generation of low-cost, low-power pulsed lasers that we recently launched in Asia.

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Cost of sales and gross margin. Cost of sales increased by \$11.2 million, or 14.1%, to \$90.6 million for the three months ended September 30, 2014 from \$79.3 million for the three months ended September 30, 2013. Our gross margin increased to 54.6% for the three months ended September 30, 2014 from 53.9% for the three months ended September 30, 2013. Gross margin increased due to reductions in product costs that were greater than the decline in the average selling prices and due to product mix which benefited from an increase in sales of medium-power lasers. Decreased product cost is the result of increased vertical integration and internal manufacturing of components which produced components more cheaply than previous purchase costs. These benefits were slightly offset by decreases in manufacturing efficiency due to increased capacity and fixed manufacturing cost and slightly lower capacity utilization.

Sales and marketing expense. Sales and marketing expense increased by \$0.7 million, or 10.2%, to \$7.5 million for the three months ended September 30, 2014 from \$6.8 million for the three months ended September 30, 2013, primarily as a result of increases in personnel, consultant and depreciation costs. As a percentage of sales, sales and marketing expense decreased to 3.8% for the three months ended September 30, 2014 from 4.0% for the three months ended September 30, 2013.

Research and development expense. Research and development expense increased by \$1.9 million, or 16.9%, to \$13.4 million for the three months ended September 30, 2014, compared to \$11.5 million for the three months ended September 30, 2013, primarily as a result of increases in personnel, material used for research and development, outside research contracts, premises and stock-based compensation costs. Much of our research and development is focused on developing new applications for fiber lasers through internal research and partnership with customers and industrial institutes. We are working on the development of new products including products operating at different wavelengths and with high energy, ultra short pulses in order to address opportunities in micro-machining applications as well as semiconductor and other non-metal processing. We are also developing complementary products and accessories such as welding and cutting heads and systems including systems used in macro and micro processing applications. In addition to new products, our research and development focuses on enhancing the performance of our internally manufactured components and refining production processes to improve electrical efficiency and reduce the costs of our products. As a percentage of sales, research and development expense remained flat at 6.7% for the three months ended September 30, 2014 and 2013.

General and administrative expense. General and administrative expense increased by \$1.0 million, or 7.6%, to \$14.2 million for the three months ended September 30, 2014 from \$13.2 million for the three months ended September 30, 2013, primarily as a result of increased personnel, consultants, stock-based compensation, legal, premises, depreciation costs and bad debt provisions. As a percentage of sales, general and administrative expense decreased to 7.1% for the three months ended September 30, 2014 from 7.7% for the three months ended September 30, 2013.

Effect of exchange rates on net sales, gross profit and operating expenses. We estimate that, if exchange rates had been the same as one year ago, net sales for the three months ended September 30, 2014 would have been \$0.8 million higher, gross profit would have been \$0.6 million higher and total operating expenses would have been \$0.5 million higher.

(Gain) loss on foreign exchange. We incurred a foreign exchange gain of \$3.6 million for the three months ended September 30, 2014 as compared to \$1.6 million loss for the three months ended September 30, 2013. The change is primarily attributable to the appreciation of the U.S. Dollar compared to the Euro, Russian Ruble and Japanese Yen. Interest (expense) income, net. Interest (expense) income, net remained relatively flat for the three months ended September 30, 2014 and 2013.

Other income, net. Other income, net was flat at \$0.2 million of income for the three months ended September 30, 2014 and 2013.

Provision for income taxes. Provision for income taxes was \$22.5 million for the three months ended September 30, 2014 compared to \$17.7 million for the three months ended September 30, 2013. The effective tax rates were 29.0% and 29.5% for the three months ended September 30, 2014 and 2013, respectively. The decrease in effective tax rate was the result of a reduction of tax reserves upon completion of a tax audit in the U.S.A. offset by the reduction of benefit for research and development credits in the U.S.A. because the underlying legislation authorizing these credits expired on December 31, 2013 and has not yet been re-enacted.

Net income attributable to IPG Photonics Corporation. Net income attributable to IPG Photonics Corporation increased by \$12.9 million to \$55.2 million for the three months ended September 30, 2014 compared to \$42.3 million for the three months ended September 30, 2013. Net income attributable to IPG Photonics Corporation as a percentage of our net sales increased by 3.0 percentage points to 27.6% for the three months ended September 30, 2014 from 24.6% for the three months ended September 30, 2013 due to the factors described above.

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Results of Operations for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013

Net sales. Net sales increased by \$80.3 million, or 16.6%, to \$562.4 million for the nine months ended September 30, 2014 from \$482.2 million for the nine months ended September 30, 2013.

| | Nine Months Ended September 30, | | 2013 | | Change | | |
|----------------------|---------------------------------|------------|-------------|------------|------------|-------|----|
| | 2014 | % of Total | 2013 | % of Total | | | |
| Materials processing | \$540,284 | 96.1 | % \$453,199 | 94.0 | % \$87,085 | 19.2 | % |
| Other applications | 22,146 | 3.9 | % 28,977 | 6.0 | % (6,831) | (23.6 |)% |
| Total | \$562,430 | 100.0 | % \$482,176 | 100.0 | % \$80,254 | 16.6 | % |

Sales for materials processing applications increased primarily due to higher sales of high-power and medium-power lasers used in cutting, welding, additive manufacturing, cladding and cleaning applications offset by declines in sales of pulsed lasers used in marking and engraving applications. We continue to see increased acceptance of the advantages of fiber laser technology. A growing number of OEM customers have developed cutting systems that use our high-power lasers and sales of these systems are increasing by displacing gas lasers in systems sold by our OEM customers. QCW laser sales are also increasing due to continued acceptance and by displacing Nd:YAG lasers in applications such as fine-welding, cutting and marking/engraving as well as penetrating new applications such as hole drilling. Increased medium-power laser sales are due to growth in underlying applications such as laser sintering and 3D manufacturing. The decrease in sales of pulsed lasers used for marking and engraving applications is due to increased competition and pricing pressure in Asia, however, during third quarter of 2014, with the introduction of a new generation of low-cost, low-power pulsed lasers, we are achieving year-over-year increases in pulsed laser sales.

Cost of sales and gross margin. Cost of sales increased by \$36.0 million, or 16.1%, to \$259.8 million for the nine months ended September 30, 2014 from \$223.8 million for the nine months ended September 30, 2013. Our gross margin increased to 53.8% from 53.6% for the nine months ended September 30, 2014 and 2013, respectively. Gross margin increased due to increased absorption of manufacturing overhead costs partially offset by increased provisions for excess or obsolete inventory.

Sales and marketing expense. Sales and marketing expense increased by \$3.2 million, or 16.4%, to \$22.7 million for the nine months ended September 30, 2014 from \$19.5 million for the nine months ended September 30, 2013, primarily as a result of increases in personnel, stock-based compensation, travel, insurance, consultants, premises costs and depreciation. As a percentage of sales, sales and marketing expense remained flat at 4.0% for the nine months ended September 30, 2014 and 2013.

Research and development expense. Research and development expense increased by \$8.8 million, or 28.6%, to \$39.6 million for the nine months ended September 30, 2014, compared to \$30.8 million for the nine months ended September 30, 2013, primarily as a result of increases in personnel, stock-based compensation, material used for research and development, outside research contracts, premises costs and depreciation. Much of our research and development is focused on developing new applications for fiber lasers through internal research and partnership with customers and industrial institutes. We are working on the development of new products including products operating at different wavelengths and with high energy, ultra short pulses in order to address opportunities in micro-machining applications as well as semiconductor and other non-metal processing. We are also developing complementary products and accessories such as welding and cutting heads and systems including systems used in macro and micro processing applications. In addition to new products, our research and development focuses on enhancing the performance of our internally manufactured components and refining production processes to improve electrical efficiency and reduce the costs of our products. As a percentage of sales, research and development expense increased to 7.0% for the nine months ended September 30, 2014 from 6.4% for the nine months ended September 30, 2013.

General and administrative expense. General and administrative expense increased by \$2.4 million, or 6.3%, to \$40.2 million for the nine months ended September 30, 2014 from \$37.8 million for the nine months ended September 30, 2013, primarily as a result of increased personnel, stock-based compensation, spending on information systems, premises, insurance, depreciation costs, bad debt provisions and loss on disposal of equipment. As a percentage of sales, general and administrative expense decreased to 7.1% for the nine months ended September 30, 2014 from

7.8% for the nine months ended September 30, 2013.

Effect of exchange rates on net sales, gross profit and operating expenses. We estimate that, if exchange rates had been the same as one year ago, net sales for the nine months ended September 30, 2014 would have been \$2.5 million lower, gross profit would have been \$1.5 million lower and total operating expenses would have been \$1.2 million higher.

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(Gain) loss on foreign exchange. We incurred a foreign exchange gain of \$4.0 million for the nine months ended September 30, 2014 as compared to a \$1.0 million gain for the nine months ended September 30, 2013. The change is primarily attributable to the changes of the U.S. Dollar against the Euro, Russian Ruble, Korean Won, Japanese Yen and Chinese Yuan.

Interest (expense) income, net. Interest (expense) income, net remained relatively flat for the nine months ended September 30, 2014 and 2013.

Other income, net. Other income, net increased to \$0.7 million of income for the nine months ended September 30, 2014 compared to approximately \$0.1 million of income for the nine months ended September 30, 2013. The amounts in the nine months ended September 30, 2013 included a \$2.9 million goodwill impairment charge partially offset by a \$2.7 million reduction in contingent consideration related to prior year acquisitions.

Provision for income taxes. Provision for income taxes was \$60.7 million for the nine months ended September 30, 2014 compared to \$50.1 million for the nine months ended September 30, 2013, representing an effective tax rate of 29.7% and 29.6% for the nine months ended September 30, 2014 and 2013, respectively. The increase in the provision for income taxes was primarily the result of increased income before provision for income taxes. The increase in effective rate was due to differences in recognition of research and development tax credits available in the United States. The American Taxpayer Relief Act of 2012 (the "Act") was signed into law on January 2, 2013 which retroactively reinstated research and development tax credits for 2012 and authorized them for 2013 as well.

Accordingly, all of the 2012 credits were recognized in the first quarter of 2013. This benefit reduced our effective tax rate as a discrete item in our tax provision for the first quarter of 2013. The legislation enabling research and development credits expired for 2014 and new legislation has not been enacted. Accordingly, there is no benefit for research and development tax credits recognized for the nine months ended September 30, 2014. This was partially offset by a reduction of tax related reserves in Q3 of 2014 upon completion of a tax audit in the U.S.A.

Net income attributable to IPG Photonics Corporation. Net income attributable to IPG Photonics Corporation increased by \$24.8 million to \$144.0 million, or 20.8% for the nine months ended September 30, 2014 compared to \$119.2 million for the nine months ended September 30, 2013. Net income attributable to IPG Photonics Corporation as a percentage of our net sales increased by 0.9 percentage points to 25.6% for the nine months ended September 30, 2014 from 24.7% for the nine months ended September 30, 2013 due to the factors described above.

Liquidity and Capital Resources

Our principal sources of liquidity as of September 30, 2014 consisted of cash and cash equivalents of \$487.5 million, unused credit lines and overdraft facilities of \$73.3 million and other working capital (excluding cash and cash equivalents) of \$247.7 million. This compares to cash and cash equivalents of \$448.8 million, unused credit lines and overdraft facilities of \$61.8 million and other working capital (excluding cash and cash equivalents) of \$237.5 million as of December 31, 2013. The increase in cash and cash equivalents of \$38.7 million from December 31, 2013 relates primarily to the following:

- Cash provided by operating activities in the nine months ended September 30, 2014 of \$124.1 million.

- Cash provided by financing activities of \$4.6 million from the exercise of stock options and their related tax benefit partially offset by payments on long-term borrowings and net payments of line-of-credit facilities.

- Cash used by investing activities of \$74.2 million which mostly relate to capital expenditures.

Our current portion of long-term debt consists of the remaining balance of a \$11.7 million secured variable-rate note. This debt matures in June 2015, at which time the outstanding debt balance would be \$10.7 million. The variable interest rate was fixed by means of an interest rate swap instrument.

We believe that our existing cash and marketable securities, our cash flows from operations and our existing lines of credit provides us with the financial flexibility to meet our liquidity and capital needs, as well as to complete certain acquisitions of complementary businesses and technologies. Our future long-term capital requirements will depend on many factors including our level of sales, the impact of economic environment on our sales levels, the timing and extent of spending to support development efforts, the expansion of the global sales and marketing activities, the timing and introductions of new products, the need to ensure access to adequate manufacturing capacity and the continuing market acceptance of our products.

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The following table details our line-of-credit facilities as of September 30, 2014:

| Description | Available Principal | Interest Rate | Maturity | Security |
|-------------------------------------|------------------------------------|-----------------------------------------------------------|--------------|----------------------------------------------------------------|
| U.S. Revolving Line of Credit (1) | Up to \$35.0 million | LIBOR plus 1.125% to 1.625%, depending on our performance | June 2015 | Unsecured |
| Euro Credit Facilities (Germany)(2) | Euro 30.0 million (\$38.1 million) | Euribor + 1.00% or EONIA 1.25% | July 2017 | Unsecured, guaranteed by parent company and Germany subsidiary |
| Euro Overdraft Facilities(3) | Euro 2.0 million (\$2.5 million) | 1.0%-6.5% | October 2015 | Common pool of assets of Italian subsidiary |

(1) \$14.1 million of this revolving credit facility is available to our foreign subsidiaries in their respective local currencies, including India, China, Japan and South Korea. There were no drawings at September 30, 2014. \$20.3 million is available to our Russian subsidiary, \$10.1 million is available to our German subsidiary, \$3.8 million of this credit facility is available to our Chinese subsidiary and \$3.8 million is available to our Italian subsidiary. At September 30, 2014, there were no amounts drawn on this line, however, there were \$1.9 million of guarantees issued against the line which reduces total availability.

(2) At September 30, 2014, there were no amounts drawn on this line, however, there were \$1.9 million of guarantees issued against the line which reduces total availability.

(3) At September 30, 2014, \$2.3 million of the \$2.5 million was drawn upon with an interest rate of 1.0%. Our largest committed credit lines are with Bank of America and Deutsche Bank in the amounts of \$35.0 million and \$38.1 million, respectively, and neither of them is syndicated.

We are required to meet certain financial covenants associated with our U.S. revolving line of credit and long-term debt facilities. These covenants, tested quarterly, include a debt service coverage ratio and a funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio. The debt service coverage covenant requires that we maintain a trailing twelve month ratio of cash flow to debt service that is greater than 1.5:1. Debt service is defined as required principal and interest payments during the period. Cash flow is defined as EBITDA less unfunded capital expenditures. The funded debt to EBITDA covenant requires that the sum of all indebtedness for borrowed money on a consolidated basis shall be less than two times our trailing twelve months EBITDA. We were in compliance with all such financial covenants as of and for the three months ended September 30, 2014.

Operating activities. Net cash provided by operating activities increased by \$63.1 million to \$124.1 million for the nine months ended September 30, 2014 from \$61.0 million for the nine months ended September 30, 2013, primarily resulting from:

- A decrease in income and other taxes payable of \$0.6 million in the nine months ended September 30, 2014 compared to a decrease of \$25.2 million in the nine months ended September 30, 2013, which included cash payments for corporation tax in Germany of approximately \$32 million for fiscal year 2011 and revised estimated payment for fiscal year 2012 that would typically have been made in the fourth quarter of 2013. Also;

- An increase in inventory of \$30.2 million in the nine months ended September 30, 2014 compared to an increase of \$43.7 million in the nine months ended September 30, 2013;

- An increase in cash provided by net income after adding back non-cash charges of \$191.4 million in the nine months ended September 30, 2014 as compared to \$163.2 million in the same period in 2013; partially offset by

- An increase in accounts receivable of \$37.9 million in the nine months ended September 30, 2014 compared to an increase of \$26.9 million in the nine months ended September 30, 2013;

- The effect of exchange rates on cash related to the appreciation of the U.S. Dollar compared to the Euro, Russian Ruble and Chinese Yuan of \$15.7 million.

Given our vertical integration, rigorous and time-consuming testing procedures for both internally manufactured and externally purchased components and the lead time required to manufacture components used in our finished products, the rate at which we turn inventory has historically been comparatively low when compared to our cost of sales. Also, investment in inventories was required to support historic and future growth rates and to enable our historic growth rates required investment in inventories to support future sales and enable us to quote short delivery times to our customers, providing what we believe is a competitive advantage. Furthermore, if there was a disruption to the manufacturing capacity of any of our key technologies, our inventories of components should enable us to continue to build finished products for a reasonable period of time. We believe that we will continue to maintain a relatively high level of inventory compared to our cost of sales. As a result, we

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expect to have a significant amount of working capital invested in inventory. A reduction in our level of net sales or the rate of growth of our net sales from their current levels would mean that the rate at which we are able to convert our inventory into cash would decrease.

Investing activities. Net cash used in investing activities was \$74.2 million and \$53.2 million in the nine months ended September 30, 2014 and 2013, respectively. The cash used in investing activities in 2014 related to the construction and purchase of new buildings in the U.S.A., Germany and Russia, purchases of machinery and equipment and the acquisition of certain patents. The cash used in investing activities in 2013 related to the construction of new buildings in the U.S.A., Germany and Russia and an acquisition during the first quarter.

We expect to incur between \$82.0 million and \$87.0 million in capital expenditures, excluding acquisitions in 2014, as we continue to upgrade facilities and add capacity worldwide to support our anticipated revenue growth. The timing and extent of any capital expenditures in and between periods can have a significant effect on our cash flow. Many of the capital expenditure projects that we undertake have long lead times and are difficult to cancel or defer to a later period.

Financing activities. Net cash provided by financing activities was \$4.6 million and \$3.4 million in the nine months ended September 30, 2014 and 2013, respectively. The cash provided by financing activities in 2014 was primarily related to the cash provided by the exercise of stock options, sales of shares under our employee stock purchase plan and the related tax benefits of the exercises partially offset by the payments on our long-term borrowings and net payments of line-of-credit facilities. The cash provided by financing activities in 2013 was primarily related to the cash provided by the exercise of stock options, sales of shares under our employee stock purchase plan and the related tax benefits of the exercises partially offset by the payments on our long-term debt and line-of-credit facilities.

Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, and we intend that such forward-looking statements be subject to the safe harbors created thereby. For this purpose, any statements contained in this Quarterly Report on Form 10-Q except for historical information are forward-looking statements. Without limiting the generality of the foregoing, words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue" or the negative or other variations thereof or comparable terminology are intended to identify forward-looking statements. In addition, any statements that refer to projections of our future financial performance, trends in our businesses, or other characterizations of future events or circumstances are forward-looking statements.

The forward-looking statements included herein are based on current expectations of our management based on available information and involve a number of risks and uncertainties, all of which are difficult or impossible to accurately predict and many of which are beyond our control. As such, our actual results may differ significantly from those expressed in any forward-looking statements. Factors that may cause or contribute to such differences include, but are not limited to, those discussed in more detail in Item 1, "Business" and Item 1A, "Risk Factors" of Part I of our Annual Report on Form 10-K for the year ended December 31, 2013. Readers should carefully review these risks, as well as the additional risks described in other documents we file from time to time with the Securities and Exchange Commission. In light of the significant risks and uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that such results will be achieved, and readers are cautioned not to rely on such forward-looking information. We undertake no obligation to revise the forward-looking statements contained herein to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Recent Accounting Pronouncements

Accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require

adoption until a future date are not expected to have a material impact on our financial statements upon adoption.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk in the ordinary course of business, which consists primarily of interest rate risk associated with our cash and cash equivalents and our debt and foreign exchange rate risk.

Interest rate risk. Our investments have limited exposure to market risk. To minimize this risk, we maintain a portfolio of cash, cash equivalents and short-term investments, consisting primarily of bank deposits, money market funds and short-term government securities. The interest rates are variable and fluctuate with current market conditions. Because of the short-term nature of these instruments, a sudden change in market interest rates would not be expected to have a material impact on our financial condition or results of operations.

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We are also exposed to market risk as a result of increases or decreases in the amount of interest expense we must pay on our bank debt and borrowings on our bank credit facilities. Our interest obligations on our long-term debt are fixed by means of an interest rate swap agreement. Although our U.S. revolving line of credit and our Euro credit facility have variable rates, we do not believe that a 10% change in market interest rates would have a material impact on our financial position or results of operations.

Exchange rates. Due to our international operations, a significant portion of our net sales, cost of sales and operating expenses are denominated in currencies other than the U.S. Dollar, principally the Euro, the Japanese Yen, the Russian Ruble, and Chinese Yuan. As a result, our international operations give rise to transactional market risk associated with exchange rate movements of the U.S. Dollar, the Euro, the Russian Ruble, the Japanese Yen and Chinese Yuan. Gain on foreign exchange transactions totaled \$3.6 million for the three months ended September 30, 2014. Loss on foreign exchange transactions totaled \$1.6 million for the three months ended September 30, 2013. Management attempts to hedge these exposures by partially or fully off-setting foreign currency denominated assets and liabilities at our subsidiaries that operate in different functional currencies. Foreign currency derivative instruments can also be used to hedge exposures and reduce the risks of certain foreign currency transactions; however, these instruments provide only limited protection and can carry significant cost. We have no foreign currency hedges as of September 30, 2014. We will continue to analyze our exposure to currency exchange rate fluctuations and may engage in financial hedging techniques in the future to attempt to minimize the effect of these potential fluctuations. Exchange rate fluctuations may adversely affect our financial results in the future.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision of our chief executive officer and our chief financial officer, our management has evaluated the effectiveness of the design and operation of our "disclosure controls and procedures" (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Evaluation Date"). Based upon that evaluation, our chief executive officer and our chief financial officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective.

Changes in Internal Controls

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are party to various legal proceedings and other disputes incidental to our business. There have been no material developments to those proceedings reported in our Annual Report on Form 10-K for the year ended December 31, 2013, and our Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, except that the plaintiff in *Dallakian v. IPG Photonics Corporation*, filed in the United States District Court of the District of Massachusetts, voluntarily dismissed the lawsuit in August 2014.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013, and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results, including the following:

Russia/Ukraine

Recent events in Ukraine have resulted in the United States and the European Union imposing and escalating sanctions on Russia and certain businesses, sectors and individuals in Russia. The United States and the European Union also suspended the granting of certain types of export licenses to Russia. Russia has imposed its own sanctions on certain individuals in the U.S. and may be considering other sanctions on the U.S. and the European Union or certain businesses or individuals from them. We have a large manufacturing facility and research and development operations in Russia which supplies components to our U.S. and German manufacturing facilities and finished lasers to our subsidiary in China. In addition, we supply components from our U.S. and German manufacturing facilities to our Russian facility. To date, we have not experienced any material disruptions or impact from current sanctions. Should there be disruption of our supplies from or to our Russian operations, or should the United States, the European Union or Russia implement different sanctions, our production and/or deliveries as well as results of operations would be affected.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

| Date | Total Number of Shares (or Units) Purchased | Average Price Paid per Share (or Unit) | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|--------------------------------------|---------------------------------------------|----------------------------------------|---------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------|
| January 1, 2014 — January 31, 2014 | — | (1) \$— | \$— | \$ — |
| February 1, 2014 — February 28, 2014 | — | (1) — | — | — |
| March 1, 2014 — March 31, 2014 | 2,639 | (1) 71.10 | — | — |
| April 1, 2014 — April 30, 2014 | — | (1) — | — | — |
| May 1, 2014 — May 31, 2014 | — | (1) — | — | — |
| June 1, 2014 — June 30, 2014 | 2,785 | (1) 68.64 | — | — |
| July 1, 2014 — July 31, 2014 | — | (1) — | — | — |
| August 1, 2014 — August 31, 2014 | 24 | (1) 67.70 | — | — |
| | 4,294 | (1) 68.78 | — | — |

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September 1, 2014 — September 30,
2014

| | | | | |
|-------|-------|---------|------|------|
| Total | 9,742 | \$69.37 | \$ — | \$ — |
|-------|-------|---------|------|------|

(1) In 2012, our Board of Directors approved "withhold to cover" as a tax payment method for vesting of restricted stock awards for certain employees. Pursuant to the "withhold to cover" method, we withheld from such employees the shares noted in the table above to cover tax withholding related to the vesting of their awards. The average prices listed in the above

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e table are averages of the fair market prices at which we valued shares withheld for purposes of calculating the number of shares to be withheld in 2014.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

| Exhibit No. | Description |
|-------------|-----------------------------------------------------------------------------------------------|
| 10.1 | Amendment to loan agreement with Bank of America, N.A. |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 1350 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

IPG PHOTONICS CORPORATION

Date: November 7, 2014

By: /s/ Valentin P. Gapontsev
Valentin P. Gapontsev
Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: November 7, 2014

By: /s/ Timothy P.V. Mammen
Timothy P.V. Mammen
Senior Vice President and Chief Financial
Officer
(Principal Financial Officer)