

IPG PHOTONICS CORP
Form 10-Q
November 03, 2015
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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, 2015
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
(Address of principal executive offices) (Zip code)
(508) 373-1100
(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company

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 October 28, 2015, there were 52,781,322 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, 2015 | December 31, 2014 |
|--|--|----------------------|
| | (In thousands, except share and per share data) | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$651,220 | \$522,150 |
| Accounts receivable, net | 154,814 | 143,109 |
| Inventories | 197,635 | 171,009 |
| Prepaid income taxes | 32,571 | 20,967 |
| Prepaid expenses and other current assets | 23,221 | 21,295 |
| Deferred income taxes, net | 18,611 | 15,308 |
| Total current assets | 1,078,072 | 893,838 |
| DEFERRED INCOME TAXES, NET | 9,237 | 5,438 |
| GOODWILL | 508 | 455 |
| INTANGIBLE ASSETS, NET | 12,744 | 9,227 |
| PROPERTY, PLANT AND EQUIPMENT, NET | 286,514 | 275,082 |
| OTHER ASSETS | 21,131 | 26,847 |
| TOTAL | \$1,408,206 | \$1,210,887 |
| LIABILITIES AND EQUITY | | |
| CURRENT LIABILITIES: | | |
| Revolving line-of-credit facilities | \$248 | \$2,631 |
| Current portion of long-term debt | 2,000 | 13,333 |
| Accounts payable | 20,862 | 17,141 |
| Accrued expenses and other liabilities | 76,913 | 64,057 |
| Deferred income taxes, net | 3,743 | 3,241 |
| Income taxes payable | 45,084 | 21,672 |
| Total current liabilities | 148,850 | 122,075 |
| DEFERRED INCOME TAXES AND OTHER LONG-TERM LIABILITIES | 25,303 | 22,584 |
| LONG-TERM DEBT, NET OF CURRENT PORTION | 18,167 | 19,667 |
| Total liabilities | 192,320 | 164,326 |
| COMMITMENTS AND CONTINGENCIES (NOTE 12) | | |
| IPG PHOTONICS CORPORATION STOCKHOLDERS' EQUITY: | | |
| Common stock, \$0.0001 par value, 175,000,000 shares authorized; 52,780,224 shares issued and outstanding at September 30, 2015; 52,369,688 shares issued and outstanding at December 31, 2014 | 5 | 5 |
| Additional paid-in capital | 597,803 | 567,617 |
| Retained earnings | 772,652 | 591,202 |
| Accumulated other comprehensive loss | (155,802) | (112,263) |
| Total IPG Photonics Corporation stockholders' equity | 1,214,658 | 1,046,561 |
| NONCONTROLLING INTERESTS | 1,228 | — |
| Total equity | 1,215,886 | 1,046,561 |
| TOTAL | \$1,408,206 | \$1,210,887 |

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, | |
|---|---------------------------------------|-----------|------------------------------------|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in thousands, except per share data) | | | |
| NET SALES | \$243,541 | \$199,651 | \$677,639 | \$562,430 |
| COST OF SALES | 110,237 | 90,561 | 307,805 | 259,829 |
| GROSS PROFIT | 133,304 | 109,090 | 369,834 | 302,601 |
| OPERATING EXPENSES: | | | | |
| Sales and marketing | 7,717 | 7,496 | 23,228 | 22,708 |
| Research and development | 16,221 | 13,447 | 45,565 | 39,593 |
| General and administrative | 14,679 | 14,172 | 42,474 | 40,212 |
| Loss (gain) on foreign exchange | 5,125 | (3,614) | (460) | (4,039) |
| Total operating expenses | 43,742 | 31,501 | 110,807 | 98,474 |
| OPERATING INCOME | 89,562 | 77,589 | 259,027 | 204,127 |
| OTHER INCOME (EXPENSE), Net: | | | | |
| Interest expense, net | (40) | (4) | (335) | (143) |
| Other income, net | 132 | 162 | 378 | 735 |
| Total other income (expense) | 92 | 158 | 43 | 592 |
| INCOME BEFORE PROVISION FOR INCOME TAXES | 89,654 | 77,747 | 259,070 | 204,719 |
| PROVISION FOR INCOME TAXES | (26,897) | (22,547) | (77,721) | (60,705) |
| NET INCOME | 62,757 | 55,200 | 181,349 | 144,014 |
| LESS: NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTERESTS | (34) | — | (101) | — |
| NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION | \$62,791 | \$55,200 | \$181,450 | \$144,014 |
| NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION PER SHARE: | | | | |
| Basic | \$1.19 | \$1.06 | \$3.45 | \$2.77 |
| Diluted | \$1.18 | \$1.05 | \$3.40 | \$2.73 |
| WEIGHTED AVERAGE SHARES OUTSTANDING: | | | | |
| Basic | 52,675 | 52,088 | 52,628 | 52,060 |
| Diluted | 53,392 | 52,792 | 53,390 | 52,780 |

See notes to consolidated financial statements.

Table of ContentsIPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|-----------|------------------------------------|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (In thousands) | | | |
| Net income | \$62,757 | \$55,200 | \$181,349 | \$144,014 |
| Other comprehensive income, net of tax: | | | | |
| Translation adjustments | (16,540) | (46,918) | (43,634) | (52,901) |
| Unrealized gain on derivatives | — | 45 | 95 | 128 |
| Total other comprehensive loss | (16,540) | (46,873) | (43,539) | (52,773) |
| Comprehensive income | 46,217 | 8,327 | 137,810 | 91,241 |
| Comprehensive loss attributable to noncontrolling interest | (285) | — | (351) | — |
| Comprehensive income attributable to IPG Photonics Corporation | \$46,502 | \$8,327 | \$138,161 | \$91,241 |
| See notes to consolidated financial statements. | | | | |

Table of ContentsIPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine Months Ended September 30, | |
|--|------------------------------------|------------|
| | 2015 | 2014 |
| | (In thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 181,349 | \$ 144,014 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 31,079 | 26,409 |
| Deferred income taxes | (7,144) | (5,954) |
| Stock-based compensation | 13,875 | 11,067 |
| Realized and unrealized gains on cash and cash equivalents and unrealized gains on foreign currency transactions | (3,893) | (4,547) |
| Other | 191 | 464 |
| Provisions for inventory, warranty & bad debt | 29,414 | 19,906 |
| Changes in assets and liabilities that (used) provided cash: | | |
| Accounts receivable | (20,004) | (37,926) |
| Inventories | (52,172) | (30,220) |
| Prepaid expenses and other current assets | 2,062 | 202 |
| Accounts payable | 4,519 | 1,324 |
| Accrued expenses and other liabilities | 3,656 | 2,653 |
| Income and other taxes payable | 17,501 | (609) |
| Tax benefit from exercise of employee stock options | (5,822) | (2,696) |
| Net cash provided by operating activities | 194,611 | 124,087 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of and deposits on property, plant and equipment | (50,759) | (72,723) |
| Purchase of intangible assets | — | (2,000) |
| Proceeds from sales of property, plant and equipment | 231 | 418 |
| Acquisition of businesses, net of cash acquired | (4,958) | — |
| Other | 63 | 66 |
| Net cash used in investing activities | (55,423) | (74,239) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from line-of-credit facilities | 7,506 | 26,051 |
| Payments on line-of-credit facilities | (9,780) | (26,836) |
| Principal payments on long-term borrowings | (12,833) | (1,000) |
| Exercise of employee stock options and issuances under employee stock purchase plan | 10,489 | 3,730 |
| Tax benefit from exercise of employee stock options | 5,822 | 2,696 |
| Net cash provided by financing activities | 1,204 | 4,641 |
| EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS | (11,322) | (15,747) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 129,070 | 38,742 |
| CASH AND CASH EQUIVALENTS — Beginning of period | 522,150 | 448,776 |
| CASH AND CASH EQUIVALENTS — End of period | \$ 651,220 | \$ 487,518 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | \$ 688 | \$ 302 |
| Cash paid for income taxes | \$ 65,376 | \$ 56,730 |
| Non-cash transactions: | | |
| Demonstration units transferred from inventory to other assets | \$ 1,995 | \$ 2,649 |

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| | | |
|---|---------|-----------|
| Inventory transferred to machinery and equipment | \$2,371 | \$1,303 |
| Additions to property, plant and equipment included in accounts payable | \$(178 |) \$1,959 |
| See notes to consolidated financial statements. | | |

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CONSOLIDATED STATEMENTS OF EQUITY

| | Nine Months Ended September 30, | | | |
|---|---|-------------|------------|-------------|
| | 2015 | | 2014 | |
| | (In thousands, except share and per share data) | | | |
| | Shares | Amount | Shares | Amount |
| COMMON STOCK | | | | |
| Balance, beginning of year | 52,369,688 | \$5 | 51,930,978 | \$5 |
| Exercise of stock options | 392,913 | — | 219,875 | — |
| Common stock issued under employee stock purchase plan | 17,623 | — | 17,518 | — |
| Balance, end of period | 52,780,224 | 5 | 52,168,371 | 5 |
| ADDITIONAL PAID-IN CAPITAL | | | | |
| Balance, beginning of year | | 567,617 | | 538,908 |
| Stock-based compensation | | 13,875 | | 11,067 |
| Exercise of stock options and related tax benefit from exercise | | 15,203 | | 5,402 |
| Common stock issued under employee stock purchase plan | | 1,108 | | 1,024 |
| Balance, end of period | | 597,803 | | 556,401 |
| RETAINED EARNINGS | | | | |
| Balance, beginning of year | | 591,202 | | 390,757 |
| Net income attributable to IPG Photonics Corporation | | 181,450 | | 144,014 |
| Balance, end of period | | 772,652 | | 534,771 |
| ACCUMULATED OTHER COMPREHENSIVE LOSS | | | | |
| Balance, beginning of year | | (112,263) | | (1,701) |
| Translation adjustments | | (43,634) | | (52,901) |
| Change in unrealized gain on derivatives, net of tax | | 95 | | 128 |
| Balance, end of period | | (155,802) | | (54,474) |
| TOTAL IPG PHOTONICS CORPORATION | | \$1,214,658 | | \$1,036,703 |
| STOCKHOLDERS' EQUITY | | | | |
| NONCONTROLLING INTERESTS | | | | |
| Balance, beginning of year | | — | | — |
| NCI of acquired company | | 1,579 | | — |
| Net loss attributable to NCI | | (101) | | — |
| Other comprehensive loss attributable to NCI | | (250) | | — |
| Balance, end of period | | 1,228 | | — |
| TOTAL STOCKHOLDERS' EQUITY | | \$1,215,886 | | \$1,036,703 |
| 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, 2014.

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, 2015 | December 31, 2014 |
|------------------------------|-----------------------|----------------------|
| Components and raw materials | \$71,297 | \$54,925 |
| Work-in-process | 35,272 | 58,603 |
| Finished goods | 91,066 | 57,481 |
| Total | \$197,635 | \$171,009 |

The Company recorded inventory provisions totaling \$4,336 and \$2,551 for the three months ended September 30, 2015 and 2014, respectively, and \$11,347 and \$8,363 for the nine months ended September 30, 2015 and 2014, 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, 2015 | December 31, 2014 |
|--|-----------------------|----------------------|
| Accrued compensation | \$32,975 | \$31,673 |
| Customer deposits and deferred revenue | 23,652 | 16,605 |
| Current portion of accrued warranty | 13,413 | 9,489 |
| Other | 6,873 | 6,290 |
| Total | \$76,913 | \$64,057 |

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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, 2015 | December 31, 2014 |
|--------------------------------------|-----------------------|----------------------|
| Revolving line-of-credit facilities: | | |
| European overdraft facilities | \$248 | \$828 |
| Euro line-of-credit | — | 1,803 |
| Total | \$248 | \$2,631 |
| Term debt: | | |
| U.S. long-term note | \$— | \$11,333 |
| Collateralized long-term note | 20,167 | 21,667 |
| Less: current portion | (2,000 |) (13,333 |
| Total long-term debt | \$18,167 | \$19,667 |

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. At September 30, 2015 and December 31, 2014, there were no amounts drawn on the U.S. line-of-credit, and there were \$2,719 and \$87, respectively, of guarantees issued against the facility which reduces the amount of the facility to draw. At September 30, 2015, there were no amounts drawn on the Euro line of credit, and there were \$9,040 and \$4,309 of guarantees issued against the facility as of September 30, 2015 and December 31, 2014, respectively, which reduces the amount of the facility available to draw. On April 30, 2015, the Company increased its U.S. line of credit with Bank of America to \$50,000 and extended the maturity to April 2020. At September 30, 2015, the amount due on the collateralized long-term note was \$20,167 of which \$2,000 is the current portion. The note is secured by the Company's corporate aircraft. The interest rate on this note is fixed at 2.81% per annum and the note matures in October 2019, at which time the outstanding debt balance would be \$12,000.

The U.S. long-term note outstanding at December 31, 2014 matured and was paid in June 2015.

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, | |
|--|-------------------------------------|----------|------------------------------------|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| Net income attributable to IPG Photonics Corporation | \$62,791 | \$55,200 | \$181,450 | \$144,014 |
| Weighted average shares | 52,675 | 52,088 | 52,628 | 52,060 |
| Dilutive effect of common stock equivalents | 717 | 704 | 762 | 720 |
| Diluted weighted average common shares | 53,392 | 52,792 | 53,390 | 52,780 |
| Basic net income attributable to IPG Photonics Corporation per share | \$1.19 | \$1.06 | \$3.45 | \$2.77 |
| Diluted net income attributable to IPG Photonics Corporation per share | \$1.18 | \$1.05 | \$3.40 | \$2.73 |

For the three months ended September 30, 2015 and 2014, respectively, the computation of diluted weighted average common shares excludes common stock equivalents of 9,000 shares and 30,000 shares which includes restricted stock units ("RSUs") of 1,600 and 1,800 and performance stock units ("PSUs") of 4,300 and 0, because the effect would be anti-dilutive. For the nine months ended September 30, 2015 and 2014, respectively, the computation of diluted weighted averages common shares excludes 40,600 shares and 61,000 shares, which includes RSUs of 24,200 and

18,000 and PSUs of 9,400 and 0 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

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(In thousands, except share and per share data)

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 no derivatives that are not accounted for as a hedging instrument.

Cash flow hedges – The Company previously had a cash flow hedge which was an interest rate swap associated with the U.S. long-term note. The interest rate swap agreement terminated with the note, which matured in June 2015. The fair value amounts in the consolidated balance sheet related to the interest rate swap were:

| Notional Amounts ¹ | | Other Assets | | Other Current Liabilities ² | | Other Long-Term Liabilities ² | |
|-------------------------------|-------------------|--------------------|-------------------|--|-------------------|--|-------------------|
| September 30, 2015 | December 31, 2014 | September 30, 2015 | December 31, 2014 | September 30, 2015 | December 31, 2014 | September 30, 2015 | December 31, 2014 |
| \$— | \$11,333 | \$— | \$— | \$— | \$151 | \$— | \$— |

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

(2) As of December 31, 2014, the remaining balance of the U.S. long-term note outstanding was considered current because the note matured in June 2015.

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, | | Nine Months Ended September 30, | |
|---|----------------------------------|---------|---------------------------------|----------|
| | 2015 | 2014 | 2015 | 2014 |
| Effective portion recognized in other comprehensive loss, pretax: | | | | |
| Interest rate swap | \$— | \$145 | \$304 | \$427 |
| Effective portion reclassified from other comprehensive loss to interest expense, pretax: | | | | |
| Interest rate swap | \$— | \$(73) | \$(153) | \$(225) |
| Ineffective portion recognized in income: | | | | |
| Interest rate swap | \$— | \$— | \$— | \$— |

8. FAIR VALUE MEASUREMENTS

The Company's financial instruments consist of cash equivalents, accounts receivable, accounts payable, drawings on revolving lines of credit, auction rate securities, 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, 2015 | | |
|-----------------------------------|-----------|---|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Assets | | | | |
| Cash equivalents | \$273,680 | \$273,680 | \$— | \$— |
| Auction rate securities | 1,134 | — | — | 1,134 |
| Total assets | \$274,814 | \$273,680 | \$— | \$1,134 |
| Liabilities | | | | |
| Contingent purchase consideration | 69 | — | — | 69 |
| Total liabilities | \$69 | \$— | \$— | \$69 |

| | Total | Fair Value Measurements at December 31, 2014 | | |
|-----------------------------------|-----------|--|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Assets | | | | |
| Cash equivalents | \$266,011 | \$266,011 | \$— | \$— |
| Auction rate securities | 1,128 | — | — | 1,128 |
| Total assets | \$267,139 | \$266,011 | \$— | \$1,128 |
| Liabilities | | | | |
| Contingent purchase consideration | \$98 | \$— | \$— | \$98 |
| Interest rate swaps | 151 | — | 151 | — |
| Total liabilities | \$249 | \$— | \$151 | \$98 |

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, | |
| | 2015 | 2014 | 2015 | 2014 |
| Auction Rate Securities | | | | |
| Balance, beginning of period | \$1,132 | \$1,124 | \$1,128 | \$1,120 |
| Change in fair value and accretion | 2 | 2 | 6 | 6 |
| Balance, end of period | \$1,134 | \$1,126 | \$1,134 | \$1,126 |
| Contingent Purchase Consideration | | | | |
| Balance, beginning of period | \$80 | \$357 | \$98 | \$375 |
| Period transactions | (7 |) — | (7 |) — |
| Change in fair value and currency fluctuations | (4 |) (259 |) (22 |) (277 |
| Balance, end of period | \$69 | \$98 | \$69 | \$98 |

9. GOODWILL AND INTANGIBLES

The carrying amount of goodwill was \$508 and \$455 on September 30, 2015 and December 31, 2014, respectively.

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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, 2015 | | | | December 31, 2014 | | | |
|-------------------------------------|-----------------------|--------------------------|---------------------|------------------------|-----------------------|--------------------------|---------------------|------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted-Average Lives | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted-Average Lives |
| Patents | \$6,641 | \$ (4,485) | \$2,156 | 6 Years | \$6,641 | \$ (4,221) | \$2,420 | 6 Years |
| Customer relationships | 3,420 | (3,178) | 242 | 5 Years | 3,660 | (3,308) | 352 | 5 Years |
| Production know-how | 6,719 | (3,168) | 3,551 | 8 Years | 6,844 | (2,630) | 4,214 | 8 Years |
| Technology, trademark and tradename | 8,535 | (1,740) | 6,795 | 8 Years | 3,315 | (1,074) | 2,241 | 8 Years |
| | \$25,315 | \$ (12,571) | \$12,744 | | \$20,460 | \$ (11,233) | \$9,227 | |

During the first quarter of 2015, the Company purchased a 76% ownership interest in RukhTekh LLC ("RuchTech"). RuchTech's fair value at the time was \$6,579. The Company paid \$5,000, which represents the fair value of its ownership interest on March 15, 2015. In connection with this purchase, the Company has included \$64 of Goodwill related to expected synergies for the Company's high-power systems product line and \$6,298 of Purchased Technology intangibles.

Amortization expense for the three months ended September 30, 2015 and 2014 was \$585 and \$527, respectively. Amortization expense for the nine months ended September 30, 2015 and 2014 was \$1,706 and \$1,604, respectively. The estimated future amortization expense for intangibles for the remainder of 2015 and subsequent years is as follows:

| 2015 | 2016 | 2017 | 2018 | 2019 | Thereafter | Total |
|-------|---------|---------|---------|---------|------------|----------|
| \$619 | \$2,422 | \$2,422 | \$2,357 | \$1,768 | \$3,156 | \$12,744 |

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, 2015 and 2014.

| | 2015 | 2014 |
|--------------------------------|----------|----------|
| Balance at January 1 | \$19,272 | \$14,997 |
| Provision for warranty accrual | 16,424 | 10,460 |
| Warranty claims | (8,627) | (7,195) |
| Foreign currency translation | (1,059) | (1,183) |
| Balance at September 30 | \$26,010 | \$17,079 |

Accrued warranty reported in the accompanying consolidated financial statements as of September 30, 2015 and December 31, 2014 consisted of \$13,413 and \$9,489 in accrued expenses and other liabilities and \$12,597 and \$9,783 in other long-term liabilities, respectively.

11. INCOME TAXES

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

| | 2015 | 2014 |
|--|---------|---------|
| Balance at January 1 | \$6,494 | \$6,501 |
| Reductions of prior period positions | — | — |
| Additions for tax positions in prior period | — | — |
| (Reductions) additions for tax positions in current period | — | (795) |

| | | |
|-------------------------|---------|---------|
| Balance at September 30 | \$6,494 | \$5,706 |
|-------------------------|---------|---------|

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(In thousands, except share and per share data)

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.

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, 2015 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.

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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 are the leading developer and manufacturer of a broad line of high-performance fiber lasers, fiber amplifiers and diode lasers that are used for diverse 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 processing 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, ranging 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 the mix of sales between laser and amplifier sources and complete systems, by sales mix between OEM customers who purchase devices from us in high unit volumes and other customers, by mix of sales in different geographies and by other factors, some of which are not under our control.

Our product mix affects our margins because the selling price per watt is generally higher for mid-power devices and certain specialty products than for high-power devices and certain 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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The mix of sales between OEM customers and other customers can affect gross margin because we provide sales price discounts on products based on the number of units ordered. As the number of OEM customers increases and the number of units ordered increases, the average sales price per unit will be reduced. We expect that the impact of reduced sales price per unit will be offset by the manufacturing efficiency provided by high unit volume orders, but the timing and extent of achieving these efficiencies may not always match the mix of sales in any given time period or be realized at all.

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 \$4.3 million and \$2.6 million for the three months ended September 30, 2015 and 2014, respectively, and \$11.3 million and \$8.4 million for nine months ended September 30, 2015 and 2014, respectively and \$11.3 million, \$15.1 million and \$8.2 million for the years ended December 31, 2014, 2013 and 2012, 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 in management, finance, legal, information technology, human resources and administration to support our worldwide operations. Legal expenses vary from quarter to quarter based primarily upon the level of litigation, transaction and compliance activities.

Foreign Exchange. Because we are a U.S. based company doing business globally, we have both translational and transactional exposure to fluctuations in foreign currency exchange rates. Changes in the relative exchange rate between the U.S. dollar and the foreign currencies in which our subsidiaries operate directly affects our sales, costs and earnings. Differences in the relative exchange rates between where we sell our products and where we incur manufacturing and other operating costs (primarily in the U.S., Germany and Russia) also affects our costs, and earnings. Certain currencies experiencing significant exchange rate fluctuations like the Euro, the Russian Ruble, the Japanese Yen and Chinese Yuan have had and could have an additional significant impact on our sales, costs and earnings. Our ability to adjust the foreign currency selling prices of products in response to changes in exchange rates is limited and may not offset the impact of the changes in exchange rates on the translated value of sales or costs. In addition, if we increase the selling price of our products in local currencies this could have a negative impact on the demand for our products.

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 28% for the nine months ended September 30, 2015 and 23%, 21% and 16% for the full years 2014, 2013 and 2012, respectively. Our largest customer accounted for 15% of our net sales for the nine months ended September 30, 2015. 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, 2015 compared to the three months ended September 30, 2014

Net sales. Net sales increased by \$43.9 million, or 22.0%, to \$243.5 million for the three months ended September 30, 2015 from \$199.7 million for the three months ended September 30, 2014.

| Three Months Ended September 30, | Change |
|----------------------------------|--------|
| 2015 | 2014 |

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| | | % of Total | | | % of Total | | | | |
|----------------------|-----------|------------|---|-----------|------------|---|----------|-------|---|
| Materials processing | \$223,813 | 91.9 | % | \$192,288 | 96.3 | % | \$31,525 | 16.4 | % |
| Other applications | 19,728 | 8.1 | % | 7,363 | 3.7 | % | 12,365 | 167.9 | % |
| Total | \$243,541 | 100.0 | % | \$199,651 | 100.0 | % | \$43,890 | 22.0 | % |

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| | Three Months Ended September 30, | | 2014 | | Change | | | |
|---|----------------------------------|------------|-------------|------------|------------|------|----|--|
| | 2015 | % of Total | | % of Total | | | | |
| High-Power Continuous Wave ("CW") Lasers | \$130,917 | 53.8 | % \$105,753 | 53.0 | % \$25,164 | 23.8 | % | |
| Medium-Power CW Lasers | 26,951 | 11.1 | % 20,619 | 10.3 | % 6,332 | 30.7 | % | |
| Low-Power CW Lasers | 2,960 | 1.2 | % 3,138 | 1.6 | % (178) | (5.7 |)% | |
| Pulsed Lasers | 35,036 | 14.4 | % 38,373 | 19.2 | % (3,337) | (8.7 |)% | |
| Quasi-Continuous Wave ("QCW") Lasers | 19,849 | 8.2 | % 14,446 | 7.2 | % 5,403 | 37.4 | % | |
| Other Revenue including Amplifiers, Laser Systems, Service, Parts, Accessories and Change in Deferred Revenue | 27,828 | 11.4 | % 17,322 | 8.7 | % 10,506 | 60.7 | % | |
| Total | \$243,541 | 100.0 | % \$199,651 | 100.0 | % \$43,890 | 22.0 | % | |

Sales for materials processing applications increased primarily due to higher sales of high-power, medium-power and QCW lasers, offset by a decline in pulsed-laser sales. High-power laser sales increased due to increased demand for cutting, welding and brazing applications. Medium-power laser sales increased due to increased demand for laser sintering/3D manufacturing and thin material cutting and welding applications. QCW laser sales increased primarily due to welding and cutting applications. These increases were partially offset by a decrease in sales of pulsed-lasers used for marking and engraving applications. We continue to see increased acceptance of the advantages of fiber laser technology for materials processing applications. A growing number of OEM customers have developed cutting systems that use our high-power lasers and sales of these systems are gaining sales from gas laser systems.

Medium-power lasers are increasingly being used for fine material processing such as cutting and welding metals in the consumer electronics industry as well as in 3D printing. We also increased sales of QCW lasers used for cutting and welding thin sheet metal as demand increased for these devices from OEM customers because they are displacing lamp pumped YAG lasers.

Sales for other applications increased due to increased sales for advanced applications and telecom applications. The increase in sales for advanced applications was driven by government and aerospace applications and contributed to increased high-power laser sales and also increased sales of certain components included in other revenue detailed above. The increase in telecom sales was driven by last mile fiber access to the home applications and increased amplifier sales which also contributed to the increase in other revenue detailed above.

Cost of sales and gross margin. Cost of sales increased by \$19.7 million, or 21.7%, to \$110.2 million for the three months ended September 30, 2015 from \$90.6 million for the three months ended September 30, 2014. Our gross margin increased to 54.7% for the three months ended September 30, 2015 from 54.6% for the three months ended September 30, 2014. Gross margin increased due to product mix including increased high-power, medium-power and QCW sales partially offset by increased unit sales of lower-margin pulsed lasers. In addition, our gross margin increased because total direct and indirect manufacturing costs increased at a slower rate than revenue as we have decreased component costs by more than the decrease in average selling prices and also because manufacturing expenses benefited from the depreciation of the Euro and Russian Ruble exchange rates. These benefits were partially offset by a slight decrease in the rate of absorption of manufacturing costs, an increase in provisions for excess and obsolete inventory and provisions for warranty reserves.

Sales and marketing expense. Sales and marketing expense increased by \$0.2 million to \$7.7 million for the three months ended September 30, 2015 from \$7.5 million for the three months ended September 30, 2014, primarily as a result of an increase in personnel and stock-based compensation costs. As a percentage of sales, sales and marketing expense decreased to 3.2% for the three months ended September 30, 2015 from 3.8% for the three months ended September 30, 2014.

Research and development expense. Research and development expense increased by \$2.8 million, or 20.6%, to \$16.2 million for the three months ended September 30, 2015, compared to \$13.4 million for the three months ended September 30, 2014, primarily as a result of an increase in personnel, stock-based compensation, premises,

depreciation and materials used for research and development. These increases were partially offset by decreased expenses related to outside research and development contracts. Research and development continues to focus on developing new products at different wavelengths including UV, green and mid-infrared lasers as well as developing end user systems, new pulsed laser products including high power pulsed products and ultra-fast pulsed products, improving the electrical efficiency of high-power products, enhancing the performance of our internally manufactured components, refining production processes to improve manufacturing yields, developing new accessories and achieving higher output powers. As a percentage of sales, research and development expense remained at 6.7% for both the three months ended September 30, 2014 and 2015.

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General and administrative expense. General and administrative expense increased by \$0.5 million, or 3.6%, to \$14.7 million for the three months ended September 30, 2015 from \$14.2 million for the three months ended September 30, 2014. This was primarily as a result of increased stock-based compensation, banking and related fees, depreciation and bad debt provisions. As a percentage of sales, general and administrative expense decreased to 6.0% for the three months ended September 30, 2015 from 7.1% for the three months ended September 30, 2014.

Effect of exchange rates on net sales, gross profit and operating expenses. We estimate that, if exchange rates relative to the U.S. Dollar had been the same as one year ago, which were on average Euro 0.75, Russian Ruble 36, Japanese Yen 104 and Chinese Yuan 6.16, respectively, we would have expected net sales to be \$20.6 million higher, gross profit to be \$9.5 million higher and total operating expenses would have been \$4.1 million higher.

Loss (gain) on foreign exchange. We incurred a foreign exchange loss of \$5.1 million for the three months ended September 30, 2015 as compared to \$3.6 million gain for the three months ended September 30, 2014. Foreign exchange losses for the three months ended September 30, 2015 were primarily attributable to the depreciation of the Chinese Yuan compared to the U.S. dollar offset by the devaluation of the Russian Ruble compared to the U.S. dollar and appreciation of the Japanese Yen compared to the Euro. Foreign exchange gains for the three months ended September 30, 2014 were primarily related to the appreciation of the U.S. Dollar compared to the Euro.

Interest expense, net. Interest expense, net remained relatively flat for the three months ended September 30, 2015 and 2014.

Other income, net. Other income, remained relatively flat for the three months ended September 30, 2015 and 2014.

Provision for income taxes. Provision for income taxes was \$26.9 million for the three months ended September 30, 2015 compared to \$22.5 million for the three months ended September 30, 2014. The effective tax rates were 30.0% and 29.0% for the three months ended September 30, 2015 and 2014, respectively. The increase in effective rate was due primarily to the mix of income earned in various tax jurisdictions. The legislation enabling research and development credits in the United States 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, 2015. Net income attributable to IPG Photonics Corporation. Net income attributable to IPG Photonics Corporation increased by \$7.6 million to \$62.8 million for the three months ended September 30, 2015 compared to \$55.2 million for the three months ended September 30, 2014. Net income attributable to IPG Photonics Corporation as a percentage of our net sales decreased by 1.8 percentage points to 25.8% for the three months ended September 30, 2015 from 27.6% for the three months ended September 30, 2014 due to the factors described above.

Results of Operations for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014

Net sales. Net sales increased by \$115.2 million, or 20.5%, to \$677.6 million for the nine months ended September 30, 2015 from \$562.4 million for the nine months ended September 30, 2014.

| | Nine Months Ended September 30, | | | | Change | | | |
|----------------------|---------------------------------|------------|-------------|------------|-------------|------|---|--|
| | 2015 | % of Total | 2014 | % of Total | | | | |
| Materials processing | \$640,302 | 94.5 | % \$540,284 | 96.1 | % \$100,018 | 18.5 | % | |
| Other applications | 37,337 | 5.5 | % 22,146 | 3.9 | % 15,191 | 68.6 | % | |
| Total | \$677,639 | 100.0 | % \$562,430 | 100.0 | % \$115,209 | 20.5 | % | |

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| | Nine Months Ended September 30, | | 2014 | | Change | | | |
|---|---------------------------------|------------|-----------|------------|-----------|---------|--|--|
| | 2015 | % of Total | 2014 | % of Total | | | | |
| High-Power CW Lasers | \$377,058 | 55.6 % | \$309,890 | 55.1 % | \$67,168 | 21.7 % | | |
| Medium-Power CW Lasers | 75,467 | 11.1 % | 59,701 | 10.6 % | 15,766 | 26.4 % | | |
| Low-Power CW Lasers | 10,190 | 1.5 % | 10,023 | 1.8 % | 167 | 1.7 % | | |
| Pulsed Lasers | 97,017 | 14.3 % | 99,615 | 17.7 % | (2,598) | (2.6 %) | | |
| QCW Lasers | 45,592 | 6.7 % | 28,129 | 5.0 % | 17,463 | 62.1 % | | |
| Other Revenue including Amplifiers, Laser Systems, Service, Parts, Accessories and Change in Deferred Revenue | 72,315 | 10.7 % | 55,072 | 9.8 % | 17,243 | 31.3 % | | |
| Total | \$677,639 | 100.0 % | \$562,430 | 100.0 % | \$115,209 | 20.5 % | | |

Sales for materials processing applications increased primarily due to higher sales of high-power, medium-power and QCW lasers. High-power laser sales increased due to increased demand for cutting, welding and surface structuring applications. Medium-power laser sales increased due to increased demand for laser sintering/3D manufacturing and thin material welding applications. QCW laser sales increased primarily due to cutting and welding applications.

These increases were partially offset by a decline in pulsed-laser sales used for marking and engraving applications.

We continue to see increased acceptance of the advantages of fiber laser technology for materials processing applications. A growing number of OEM customers have developed cutting systems that use our high-power lasers and sales of these systems are gaining sales from gas laser systems. Medium-power lasers are increasingly being used for fine material processing such as cutting and welding metals in the consumer electronics industry as well as in 3D printing. We also increased sales of QCW lasers used for cutting and welding thin sheet metal as demand increased for these devices from OEM customers because they are displacing lamp pumped YAG lasers.

Sales for other applications increased due to increased sales for advanced applications, telecom applications and medical applications. The increase in sales for advanced applications was driven by government and aerospace applications and contributed to increased high-power laser sales and also increased sales of certain components included in other revenue detailed above. The increase in telecom sales was driven by last mile fiber access to the home applications and increased amplifier sales which also contributed to the increase in other revenue detailed above. The increase in sales for medical applications contributed to the increase in low-power laser sales.

Cost of sales and gross margin. Cost of sales increased by \$48.0 million, or 18.5%, to \$307.8 million for the nine months ended September 30, 2015 from \$259.8 million for the nine months ended September 30, 2014. Our gross margin increased to 54.6% from 53.8% for the nine months ended September 30, 2015 and 2014, respectively. Gross margin increased due to product mix including increased high-power, medium-power and QCW sales partially offset by increased unit sales of lower-margin pulsed-lasers. In addition, our gross margin increased because total direct and indirect manufacturing costs increased at a slower rate than revenue as we have decreased component costs by more than the decrease in average selling prices and also because manufacturing expenses benefited from the depreciation of the Euro and Russian Ruble exchange rates. These benefits were partially offset by a slight decrease in the rate of absorption of manufacturing costs, an increase in provisions for excess and obsolete inventory and provisions for warranty reserves.

Sales and marketing expense. Sales and marketing expense increased by \$0.5 million, or 2.3%, to \$23.2 million for the nine months ended September 30, 2015 from \$22.7 million for the nine months ended September 30, 2014, primarily as a result of increases in personnel, stock-based compensation, travel, marketing costs and depreciation. As a percentage of sales, sales and marketing expense decreased to 3.4% for the nine months ended September 30, 2015 from 4.0% for the nine months ended September 30, 2014.

Research and development expense. Research and development expense increased by \$6.0 million, or 15.1%, to \$45.6 million for the nine months ended September 30, 2015, compared to \$39.6 million for the nine months ended September 30, 2014, primarily as a result of an increase in personnel, stock-based compensation, premises and depreciation and materials used for research and development. These increases were partially offset by decreased expenses related to outside research and development contracts. Research and development continues to focus on

developing new products at different wavelengths including UV, green and mid-infrared lasers as well as developing end user systems, new pulsed laser products including high power pulsed products and ultra-fast pulsed products, improving the electrical efficiency of high power products, enhancing the performance of our internally manufactured components, refining production processes to improve manufacturing yields,

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developing new accessories and achieving higher output powers. As a percentage of sales, research and development expense decreased to 6.7% for the nine months ended September 30, 2015 from 7.0% for the nine months ended September 30, 2014.

General and administrative expense. General and administrative expense increased by \$2.3 million, or 5.6%, to \$42.5 million for the nine months ended September 30, 2015 from \$40.2 million for the nine months ended September 30, 2014, primarily as a result of increased personnel, stock-based compensation, banking and related fees, depreciation costs and bad debt provisions. As a percentage of sales, general and administrative expense decreased to 6.3% for the nine months ended September 30, 2015 from 7.1% for the nine months ended September 30, 2014.

Effect of exchange rates on net sales, gross profit and operating expenses. We estimate that, if exchange rates relative to the U.S. Dollar had been the same as one year ago, which were on average Euro 0.74, Russian Ruble 35, Japanese Yen 103 and Chinese Yuan 6.15, respectively, we would have expected net sales for the nine months ended September 30, 2015 to be \$61.9 million higher, gross profit to be \$30.2 million higher and total operating expenses would have been \$12.3 million higher.

Loss (gain) on foreign exchange. We incurred a foreign exchange gain of \$0.5 million for the nine months ended September 30, 2015 as compared to a \$4.0 million gain for the nine months ended September 30, 2014. The change is primarily attributable to the changes of the U.S. Dollar against the Euro, Russian Ruble and Chinese Yuan. For the nine months ended September 30, 2015, gains are primarily attributable to US Dollar appreciation compared to the Euro offset by Chinese Yuan depreciation compared to the US Dollar. Foreign exchange gains for the nine months ended September 30, 2014 were primarily attributable to the US Dollar appreciation compared to the Euro and Russian Ruble.

Interest expense, net. Interest expense, net increased to \$0.3 million for the nine months ended September 30, 2015 from \$0.1 million for the nine months ended September 30, 2014.

Other income, net. Other income, net decreased to \$0.4 million of income for the nine months ended September 30, 2015 compared to approximately \$0.7 million of income for the nine months ended September 30, 2014.

Provision for income taxes. Provision for income taxes was \$77.7 million for the nine months ended September 30, 2015 compared to \$60.7 million for the nine months ended September 30, 2014, representing an effective tax rate of 30.0% and 29.7% for the nine months ended September 30, 2015 and 2014, respectively. The increase in effective rate was due primarily to the mix of income earned in various tax jurisdictions. The legislation enabling research and development credits in the United States 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, 2015.

Net income attributable to IPG Photonics Corporation. Net income attributable to IPG Photonics Corporation increased by \$37.4 million to \$181.5 million, or 26.0% for the nine months ended September 30, 2015 compared to \$144.0 million for the nine months ended September 30, 2014. Net income attributable to IPG Photonics Corporation as a percentage of our net sales increased by 1.2 percentage points to 26.8% for the nine months ended September 30, 2015 from 25.6% for the nine months ended September 30, 2014 due to the factors described above.

Liquidity and Capital Resources

Our principal sources of liquidity as of September 30, 2015 consisted of cash and cash equivalents of \$651.2 million, unused credit lines and overdraft facilities of \$74.0 million and other working capital (excluding cash and cash equivalents) of \$278.0 million. This compares to cash and cash equivalents of \$522.2 million, unused credit lines and overdraft facilities of \$66.9 million and other working capital (excluding cash and cash equivalents) of \$249.6 million as of December 31, 2014. The increase in cash and cash equivalents of \$129.1 million from December 31, 2014 relates primarily to the following:

- Cash provided by operating activities in the nine months ended September 30, 2015 of \$194.6 million.

- Cash used in investing activities of \$55.4 million which mostly relate to capital expenditures and the purchase of a majority interest of a company in the first quarter.

- Cash provided by financing activities of \$1.2 million from the exercise of stock options, sales of shares under our employee stock purchase plan and their related tax benefits partially offset by the payments on long-term borrowings and net payments of line-of-credit facilities.

Our long-term debt consists of a \$21.7 million secured note with a remaining principal balance of \$20.2 million as of September 30, 2015. The note is secured by our corporate aircraft. Of this amount, \$2.0 million is the current portion. The interest rate is fixed at 2.81% per annum and the note matures in October 2019, at which time the outstanding debt balance would be \$12.0 million.

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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.

The following table details our line-of-credit facilities as of September 30, 2015:

| Description | Total Facility | Interest Rate LIBOR plus | Maturity | Security |
|------------------------------------|------------------------------------|--|--------------|--|
| U.S. Revolving Line-of-Credit (1) | Up to \$50.0 million | 0.80% to 1.20%, depending on our performance | April 2020 | Unsecured |
| Euro Credit Facility (Germany) (2) | Euro 30.0 million (\$33.7 million) | Euribor plus 1.00% or EONIA 1.25% | July 2017 | Unsecured, guaranteed by parent company and Germany subsidiary |
| Euro Overdraft Facilities (3) | Euro 2.0 million (\$2.2 million) | 1.0%-6.5% | October 2015 | Common pool of assets of Italian subsidiary |

Effective April 30, 2015, the U.S. Revolving Line-of-Credit was amended and the amount available was increased from \$35 million to \$50 million. This facility is available to our foreign subsidiaries in their respective local currencies. At September 30, 2015, there were no drawings however, there were \$2.7 million of guarantees issued against the facility which reduces the amount of the facility available to draw.

This Euro Credit Facility is also available to our Russian, Italian and Chinese subsidiaries. At September 30, 2015, there were no drawings upon the facility, however, there were \$9.0 million of guarantees issued against the facility which reduces the amount of the facility available to draw.

At September 30, 2015, \$0.2 million of the \$2.2 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 \$50.0 million and \$33.7 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 facility. 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 at least 1.5:1. Debt service is defined as required principal and interest payments during the period. Debt service in the calculation is decreased by our cash held in the U.S.A. in excess of \$50 million up to a maximum of \$250 million. 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 be less than three 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, 2015.

Operating activities. Net cash provided by operating activities increased by \$70.5 million to \$194.6 million for the nine months ended September 30, 2015 from \$124.1 million for the nine months ended September 30, 2014, primarily resulting from:

- An increase in cash provided by net income after adding back non-cash charges of \$53.5 million to \$244.9 million in the nine months ended September 30, 2015 as compared to \$191.4 million in the same period in 2014;

- An increase in income and other taxes payable of \$17.5 million in the nine months ended September 30, 2015 as compared to a decrease of \$0.6 million in the same period in 2014;

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- An increase in accounts payable of \$4.5 million in the nine months ended September 30, 2015 as compared to an increase of \$1.3 million in the same period in 2014; partially offset by
- An increase in accrued expenses and other liabilities of \$3.7 million in the nine months ended September 30, 2015 as compared to an increase of \$2.7 million in the same period in 2014;
- An increase in prepaid expenses and other current assets of \$2.1 million in the nine months ended September 30, 2015 as compared to an increase of \$0.2 million in the same period in 2014; partially offset by
- An increase in inventory of \$52.2 million in the nine months ended September 30, 2015 as compared to an increase of \$30.2 million in the same period in 2014;

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An increase in accounts receivable of \$20.0 million in the nine months ended September 30, 2015 as compared to an increase of \$37.9 million in the same period in 2014;

An increase in the tax benefit from exercise of employee stock options of \$5.8 million in the nine months ended September 30, 2015 as compared to an increase of \$2.7 million in the same period in 2014 and

The effect of exchange rates on cash related to the appreciation of the U.S. Dollar compared to the Chinese Yuan, Euro and Russian Ruble of \$11.3 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, 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 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 \$55.4 million and \$74.2 million in the nine months ended September 30, 2015 and 2014, respectively. The cash used in investing activities in 2015 related to the construction of new buildings in the U.S.A., Germany and Russia, purchases of machinery and equipment and the purchase of a majority interest in a company in the first quarter. The cash used in investing activities in 2014 related to the construction and purchase of new buildings in the United States, Germany and Russia, purchases of machinery and equipment and the acquisition of certain patents.

We expect to incur between \$60 million and \$65 million in capital expenditures, excluding acquisitions in 2015, 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 \$1.2 million and \$4.6 million in the nine months ended September 30, 2015 and 2014, respectively. The cash provided by financing activities in 2015 was primarily related 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 of which \$10.7 million related to the final payment on the U.S. long-term note that matured in June and net payments of line-of-credit facilities. 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.

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, 2014. 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

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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 and corporate 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.

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 debt and borrowings on our bank credit facilities. 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 Russian Ruble, the Japanese Yen 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 the Chinese Yuan. Loss on foreign exchange transactions totaled \$5.1 million for the three months ended September 30, 2015 and a gain of \$3.6 million for the three months ended September 30, 2014, respectively. Gain on foreign exchange transactions totaled \$0.5 million and \$4.0 million for the nine months ended September 30, 2015 and 2014, respectively. Management attempts to minimize these exposures by partially or fully off-setting foreign currency denominated assets and liabilities at our subsidiaries that operate in different functional currencies. The effectiveness of this strategy can be limited by the volume of underlying transactions at various subsidiaries and by our ability to accelerate or delay inter-company cash settlements. As a result, we are unable to create a perfect offset of the foreign currency denominated assets and liabilities. Furthermore, if the forecast or trend for a certain currency is expected, in the medium or long term, to be in a certain direction we have, on occasions, chosen not to try to off-set the assets or liabilities. At September 30, 2015, our material foreign currency exposure is net U.S. Dollar denominated assets at subsidiaries where the Euro or the Russian Ruble is the functional currency and U.S. Dollar denominated liabilities where the Chinese Yuan is the functional currency. The net U.S. Dollar denominated assets are comprised of cash, third party receivables, inter-company receivables and inter-company notes offset by third party and inter-company U.S. Dollar denominated payables. The U.S. Dollar denominated liabilities are comprised of inter-company payables. A 5% change in the relative exchange rate of the U.S. Dollar to the Euro as of September 30, 2015 applied to the net U.S. Dollar asset balances, would result in a foreign exchange gain of \$4.1 million if the U.S. Dollar appreciated and a \$4.1 million foreign exchange loss if the U.S. Dollar depreciated.

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 derivative instrument hedges as of September 30, 2015. 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.

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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, 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, 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.

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, 2015 — January 31, 2015 | — | (1) \$— | \$— | \$ — |
| February 1, 2015 — February 28, 2015 | — | (1) — | — | — |
| March 1, 2015 — March 31, 2015 | 2,945 | (1) 93.29 | — | — |
| April 1, 2015 — April 30, 2015 | — | (1) — | — | — |
| May 1, 2015 — May 31, 2015 | — | (1) — | — | — |
| June 1, 2015 — June 30, 2015 | 2,823 | (1) 86.53 | — | — |
| July 1, 2015 — July 31, 2015 | — | (1) — | — | — |
| August 1, 2015 — August 31, 2015 | 448 | (1) 92.22 | — | — |
| September 1, 2015 — September 30, 2015 | 2,594 | (1) 75.97 | — | — |
| Total | 8,810 | \$85.97 | \$— | \$ — |

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 (1) 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 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 2015.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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(a) Exhibits

| Exhibit No. | Description |
|-------------|---|
| 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 3, 2015

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

Date: November 3, 2015

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