

IPG PHOTONICS CORP  
Form 10-Q  
August 03, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2012

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)

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

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

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

**01540**  
(Zip code)

**(508) 373-1100**

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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 July 30, 2012, there were 51,074,936 shares of the registrant's common stock issued and outstanding.

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

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
	<b>(In thousands, except share and per share data)</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 345,578	\$ 180,234
Short-term investments	9,765	25,451
Accounts receivable, net	86,132	75,755
Inventories, net	121,979	116,978
Prepaid income taxes and income taxes receivable	13,946	13,285
Prepaid expenses and other current assets	14,516	11,855
Deferred income taxes, net	11,041	10,899
Total current assets	602,957	434,457
DEFERRED INCOME TAXES, NET	6,660	4,830
INTANGIBLE ASSETS, NET	4,946	6,157
PROPERTY, PLANT AND EQUIPMENT, NET	177,441	155,202
OTHER ASSETS	6,010	7,486
<b>TOTAL</b>	<b>\$ 798,014</b>	<b>\$ 608,132</b>
<b>LIABILITIES AND EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Revolving line-of-credit facilities	\$ 4,037	\$ 7,057
Current portion of long-term debt	1,580	1,613
Accounts payable	13,200	11,122
Accrued expenses and other liabilities	46,225	47,285
Deferred income taxes, net	7,545	5,405
Income taxes payable	31,191	21,230
Total current liabilities	103,778	93,712
OTHER LONG-TERM LIABILITIES	9,834	8,961
LONG-TERM DEBT, NET OF CURRENT PORTION	14,671	15,726
Total liabilities	128,283	118,399
REDEEMABLE NONCONTROLLING INTERESTS		46,123
COMMITMENTS AND CONTINGENCIES (NOTE 13)		
<b>IPG PHOTONICS CORPORATION STOCKHOLDERS' EQUITY:</b>		
Common stock, \$0.0001 par value, 175,000,000 shares authorized; 51,065,627 shares issued and outstanding at June 30, 2012; 47,616,115 shares issued and outstanding at December 31, 2011	5	5
Additional paid-in capital	499,951	332,585
Retained earnings	190,983	122,833
Accumulated other comprehensive loss	(21,208)	(12,100)

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Total IPG Photonics Corporation stockholders equity	669,731	443,323
NONCONTROLLING INTERESTS		287
Total equity	669,731	443,610
TOTAL	\$ 798,014	\$ 608,132

See notes to consolidated financial statements.

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**IPG PHOTONICS CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

	Three Months Ended June 30, 2012	2011	Six Months Ended June 30, 2012	2011
	(in thousands, except per share data)			
NET SALES	\$ 137,927	\$ 121,936	\$ 261,119	\$ 221,894
COST OF SALES	63,017	55,230	117,525	101,522
<b>GROSS PROFIT</b>	<b>74,910</b>	<b>66,706</b>	<b>143,594</b>	<b>120,372</b>
OPERATING EXPENSES:				
Sales and marketing	5,854	5,847	10,986	10,795
Research and development	7,229	6,610	14,369	12,341
General and administrative	8,736	8,333	18,685	16,502
(Gain) loss on foreign exchange	(3,354)	(206)	(2,068)	514
<b>Total operating expenses</b>	<b>18,465</b>	<b>20,584</b>	<b>41,972</b>	<b>40,152</b>
<b>OPERATING INCOME</b>	<b>56,445</b>	<b>46,122</b>	<b>101,622</b>	<b>80,220</b>
OTHER INCOME (EXPENSE), Net:				
Interest income (expense), net	615	(170)	486	(376)
Other expense, net	(92)	(618)	(1,186)	(610)
<b>Total other income (expense)</b>	<b>523</b>	<b>(788)</b>	<b>(700)</b>	<b>(986)</b>
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>56,968</b>	<b>45,334</b>	<b>100,922</b>	<b>79,234</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>(17,119)</b>	<b>(13,827)</b>	<b>(30,525)</b>	<b>(24,349)</b>
<b>NET INCOME</b>	<b>39,849</b>	<b>31,507</b>	<b>70,397</b>	<b>54,885</b>
<b>LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS</b>	<b>2,107</b>	<b>771</b>	<b>2,740</b>	<b>1,081</b>
<b>NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION</b>	<b>\$ 37,742</b>	<b>\$ 30,736</b>	<b>\$ 67,657</b>	<b>\$ 53,804</b>
NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION PER SHARE:				
Basic	\$ 0.74	\$ 0.65	\$ 1.37	\$ 1.14
Diluted	\$ 0.72	\$ 0.63	\$ 1.34	\$ 1.11
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	50,989	47,310	49,717	47,205
Diluted	52,071	48,610	50,826	48,650

See notes to consolidated financial statements.

**Table of Contents****IPG PHOTONICS CORPORATION****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>			
Net income	\$ 39,849	\$ 31,507	\$ 70,397	\$ 54,885
Other comprehensive (loss) income, net of tax:				
Translation adjustments	(21,846)	3,736	(6,803)	17,335
Unrealized gain (loss) on derivatives	49	(102)	106	13
<b>Total other comprehensive (loss) income</b>	<b>(21,797)</b>	<b>3,634</b>	<b>(6,697)</b>	<b>17,348</b>
Comprehensive income	\$ 18,052	\$ 35,141	\$ 63,700	\$ 72,233
Comprehensive (loss) income attributable to noncontrolling interest & redeemable noncontrolling interest	(857)	1,295	1,908	2,239
Comprehensive income attributable to IPG Photonics Corporation	\$ 18,909	\$ 33,846	\$ 61,792	\$ 69,994

See notes to consolidated financial statements.

**Table of Contents****IPG PHOTONICS CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 70,397	\$ 54,885
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,358	11,955
Deferred income taxes	389	6,624
Stock-based compensation	4,199	4,301
Unrealized (gains) losses on foreign currency transactions	(865)	551
Other	12	530
Provisions for inventory, warranty & bad debt	8,502	7,056
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	(13,301)	(16,928)
Inventories	(10,148)	(35,193)
Prepaid expenses and other current assets	(1,296)	(4,555)
Accounts payable	2,184	4,888
Accrued expenses and other liabilities	(3,922)	(2,693)
Income and other taxes payable	11,041	1,829
Tax benefit from exercise of employee stock options	(1,095)	(6,258)
Net cash provided by operating activities	78,455	26,992
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment and intangible assets	(35,966)	(22,786)
Proceeds from short-term investments	15,687	
Acquisition of businesses, net of cash acquired		(450)
Other	(39)	112
Net cash used in investing activities	(20,318)	(23,124)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from line-of-credit facilities	6,949	6,951
Payments on line-of-credit facilities	(9,692)	(6,817)
Purchase of noncontrolling interests	(700)	
(Purchase) sale of redeemable noncontrolling interests	(55,400)	19,973
Principal payments on long-term borrowings	(1,476)	(666)
Exercise of employee stock options and issuances under employee stock purchase plan	2,249	3,989
Tax benefit from exercise of employee stock options	1,095	6,258
Proceeds from follow-on public offering, net of offering expenses	168,022	
Net cash provided by financing activities	111,047	29,688
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(3,840)	6,780
NET INCREASE IN CASH AND CASH EQUIVALENTS	165,344	40,336
CASH AND CASH EQUIVALENTS Beginning of period	180,234	147,860

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CASH AND CASH EQUIVALENTS    End of period	\$ 345,578	\$ 188,196
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### SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid for interest	\$ 411	\$ 514
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Cash paid for income taxes	\$ 14,446	\$ 14,905
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#### Non-cash transactions:

Demonstration units transferred from inventory to other assets	\$ 1,182	\$ 1,291
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Amounts related to acquisition of businesses included in accounts payable and accrued expenses and other liabilities	\$	\$ 882
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Additions to property, plant and equipment included in accounts payable	\$ 537	\$ 545
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Change in fair value of warrant	\$	\$ 654
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Property purchase financed with debt	\$	\$ 1,851
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See notes to consolidated financial statements.

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**IPG PHOTONICS CORPORATION**  
**CONSOLIDATED STATEMENTS OF EQUITY**

	Six Months Ended June 30,			
	2012		2011	
	(In thousands, except share and per share data)			
	Shares	Amount	Shares	Amount
<b>COMMON STOCK</b>				
Balance, beginning of year	47,616,115	\$ 5	46,988,566	\$ 5
Exercise of stock options	181,437		433,050	
Common stock issued under employee stock purchase plan	18,075		16,072	
Common stock issued in a public offering	3,250,000			
Balance, end of period	51,065,627	5	47,437,688	5
<b>ADDITIONAL PAID-IN CAPITAL</b>				
Balance, beginning of year		332,584		310,218
Stock-based compensation		4,199		4,301
Exercise of stock options and related tax benefit from exercise		2,801		9,830
Common stock issued under employee stock purchase plan		543		417
Fair value of warrant transferred to additional paid-in capital				674
(Purchase) sale of redeemable noncontrolling interests ( NCI )		(7,794)		10,138
Increase redeemable NCI to initial redemption value				(9,795)
Common stock issued in follow-on public offering		168,022		
Premium on purchase of NCI		(404)		
Balance, end of period		499,951		325,783
<b>RETAINED EARNINGS</b>				
Balance, beginning of year		122,833		5,567
Net income attributable to IPG Photonics Corporation		67,657		53,804
Adjustments to redemption value of redeemable NCI		493		
Balance, end of period		190,983		59,371
<b>ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME</b>				
Balance, beginning of year		(12,100)		810
Translation adjustments		(6,803)		17,335
Unrealized gain on derivatives, net of tax		106		13
Purchase of NCI & redeemable NCI		(3,243)		
Attribution to NCI & redeemable NCI		832		(1,158)
Balance, end of period		(21,208)		17,000
<b>TOTAL IPG PHOTONICS CORPORATION STOCKHOLDERS EQUITY</b>		<b>669,731</b>		<b>402,159</b>
<b>NONCONTROLLING INTERESTS</b>				
Balance, beginning of year		287		203
Net income attributable to NCI				31
Sale of NCI		(700)		

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Other comprehensive income attributable to NCI	9	11
Premium on purchase of NCI	404	
Balance, end of period		245
TOTAL STOCKHOLDERS EQUITY	\$ 669,731	\$ 402,404

See notes to consolidated financial statements.

**Table of Contents****IPG PHOTONICS CORPORATION****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, 2011.

The Company recognizes revenue in accordance with Accounting Standards Update No. (ASU) 2009-13. Revenue from orders with multiple deliverables is divided into separate units of accounting when certain criteria are met. These separate units generally consist of equipment and installation. The consideration for the arrangement is then allocated to the separate units of accounting based on their relative selling prices. The selling price of equipment is based on vendor specific objective evidence and the selling price of installation is based on third party evidence. Applicable revenue recognition criteria are then applied separately for each separate unit of accounting. Equipment revenue is generally recognized upon the transfer of ownership which is typically at the time of shipment. Installation revenue is recognized upon completion of the installation service which is typically completed within 30 to 90 days of delivery. Returns and customer credits are infrequent and are recorded as a reduction to revenue. Rights of return are generally not included in sales arrangements.

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**

In June 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, which amends current comprehensive income guidance. This accounting update eliminated the option to present the components of other comprehensive income as part of the statement of stockholders' equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. The Company adopted ASU 2011-05 in the first quarter of 2012. This adoption did not have an impact on the statement of financial condition as it only required a change in the ordering of its financial statements.

**3. INVENTORIES, NET**

Inventories consist of the following:

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Components and raw materials	\$ 44,053	\$ 41,107
Work-in-process	40,586	40,380
Finished goods	37,340	35,491
Total	\$ 121,979	\$ 116,978

The Company recorded inventory provisions totaling \$1,793 and \$1,190 for the three months ended June 30, 2012 and 2011, respectively, and \$3,643 and \$2,239 for the six months ended June 30, 2012 and 2011, respectively. These provisions relate to the recoverability of the value of

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inventories due to technological changes and excess quantities. These provisions are reported as a reduction to components and raw materials and finished goods.

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Accrued expenses and other liabilities consist of the following:

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Accrued compensation	\$ 16,819	\$ 21,453
Customer deposits and deferred revenue	18,623	15,317
Current portion of accrued warranty	6,687	6,186
Other	4,096	4,329
<b>Total</b>	<b>\$ 46,225</b>	<b>\$ 47,285</b>

**5. FINANCING ARRANGEMENTS**

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

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
<b>Revolving line-of-credit facilities:</b>		
Euro line-of-credit	\$ 3,402	\$ 2,421
Foreign subsidiary drawings on U.S. line-of-credit	382	4,243
Other European facilities	253	393
<b>Total</b>	<b>\$ 4,037</b>	<b>\$ 7,057</b>
<b>Term Debt:</b>		
U.S. long-term note	\$ 14,667	\$ 15,333
Other notes payable	1,584	2,006
Less: current portion	(1,580)	(1,613)
<b>Total long-term debt</b>	<b>\$ 14,671</b>	<b>\$ 15,726</b>

The U.S. line of credit is available to certain foreign subsidiaries and allows for borrowings in the local currencies of those subsidiaries.

**Table of Contents****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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income attributable to IPG Photonics Corporation	\$ 37,742	\$ 30,736	\$ 67,657	\$ 53,804
Adjustments to redemption value of redeemable noncontrolling interests			493	
Net income attributable to common stockholders	37,742	30,736	68,150	53,804
Weighted average shares	50,989	47,310	49,717	47,205
Dilutive effect of common stock equivalents	1,082	1,300	1,109	1,445
Diluted weighted average common shares	52,071	48,610	50,826	48,650
Basic net income attributable to IPG Photonics Corporation per share	\$ 0.74	\$ 0.65	\$ 1.36	\$ 1.14
Adjustments to redemption value of redeemable noncontrolling interests			0.01	
Basic net income attributable to common stockholders	\$ 0.74	\$ 0.65	\$ 1.37	\$ 1.14
Diluted net income attributable to IPG Photonics Corporation per share	\$ 0.72	\$ 0.63	\$ 1.33	\$ 1.11
Adjustments to redemption value of redeemable noncontrolling interests			0.01	
Diluted net income attributable to common stockholders	\$ 0.72	\$ 0.63	\$ 1.34	\$ 1.11

The computation of diluted weighted average common shares excludes options to purchase 14,000 shares and 89,000 shares for the three months ended June 30, 2012 and 2011, respectively, and 14,000 shares and 89,000 shares for the six months ended June 30, 2012 and 2011, respectively, because the effect would be anti-dilutive.

**7. DERIVATIVE FINANCIAL 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 used foreign currency forward contracts as cash flow hedges of forecasted intercompany settlements denominated in foreign currencies of major industrial countries. The Company has no outstanding foreign currency forward contracts. The Company has interest rate swaps that are 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 hedges are interest rate swaps under which it pays fixed rates of interest. The fair value amounts in the consolidated balance sheets were:

Notional Amounts <sup>1</sup>		Other Assets		Other Long-Term Liabilities	
June 30,	December 31,	June 30,	December 31,	June 30,	December 31,

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	2012	2011	2012	2011	2012	2011
Interest rate swap	\$ 14,667	\$ 15,333	\$	\$	\$ 1,071	\$ 1,223
Total	\$ 14,667	\$ 15,333	\$	\$	\$ 1,071	\$ 1,223

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Effective portion recognized in other comprehensive (loss) gain, pretax:				
Interest rate swap	\$ 210	\$ 1	\$ 448	\$ 340
Effective portion reclassified from other comprehensive (loss) gain to interest expense, pretax:				
Interest rate swap	\$ (148)	\$ (164)	\$ (296)	\$ (319)
Ineffective portion recognized in income:				
Interest rate swap	\$	\$	\$	\$

**8. REDEEMABLE NONCONTROLLING INTERESTS**

In December 2010 and June 2011, the Company sold a 22.5% minority interest (the Minority Interest) of its Russian subsidiary, NTO IRE-Polus (NTO), to the Russian Corporation for Nanotechnologies (Rusnano) for \$45,000. In addition, the Company had a call option commencing in December 2013 to buy back the Minority Interest at a predetermined value and Rusnano had a warrant to purchase an additional 2.5% interest in NTO and a put option commencing in December 2015 to sell its Minority Interest to the Company at a predetermined value. On June 29, 2012, the Company repurchased the Minority Interest for \$55,400 cash and, under the terms of the agreement, the warrant and the put and call options were terminated. Due to the put rights, the Minority Interest was reported as a liability other than permanent equity under ASC 480-10-S99-3A. Based upon the Company's valuation of the Minority Interest, the amount paid to repurchase the Minority Interest did not exceed its fair value. Accordingly, as per ASC 480-10-S99-3A, the Company recorded the amount paid in excess of carrying amount in additional paid-in capital.

The following is a reconciliation of the reported amounts in the accompanying consolidated financial statements as of June 30, 2012:

	Redeemable Noncontrolling Interest ( NCI )
Balance at January 1, 2012	\$ 46,123
Net income attributable to redeemable NCI	2,740
Other comprehensive income attributable to redeemable NCI	(841)
Adjustments to redemption value	(493)
Carrying value of redeemable NCI at purchase date	\$ 47,529
Purchase of NCI in excess of carrying amount	7,794
Sale of NCI, less warrant value	(55,323)
Balance at June 30, 2012	\$

**9. FAIR VALUE MEASUREMENTS**

The Company's financial instruments consist of 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.

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

	Fair Value Measurements at June 30, 2012			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Money market funds	\$ 17,748	\$ 17,748	\$	\$
Treasury bills	158,959	158,959		
Time deposits	38,692	38,692		
Auction rate securities	1,103			1,103
<b>Total assets</b>	<b>\$ 216,502</b>	<b>\$ 215,399</b>	<b>\$</b>	<b>\$ 1,103</b>
<b>Liabilities</b>				
Contingent purchase consideration	\$ 597	\$	\$	\$ 597
Interest rate swaps	1,071		1,071	
<b>Total liabilities</b>	<b>\$ 1,668</b>	<b>\$</b>	<b>\$ 1,071</b>	<b>\$ 597</b>

	Fair Value Measurements at December 31, 2011			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Money market funds	\$ 18,466	\$ 18,466	\$	\$
Treasury bills	58,994	58,994		
Time deposits	33,513	33,513		
Auction rate securities	1,104			1,104
<b>Total assets</b>	<b>\$ 112,077</b>	<b>\$ 110,973</b>	<b>\$</b>	<b>\$ 1,104</b>
<b>Liabilities</b>				
Contingent purchase consideration	\$ 999	\$	\$	\$ 999
Warrant	77			77
Interest rate swaps	1,223		1,223	
<b>Total liabilities</b>	<b>\$ 2,299</b>	<b>\$</b>	<b>\$ 1,223</b>	<b>\$ 1,076</b>

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 the 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. During the six months ended June 30, 2012, the Company made a final payment of contingent consideration and other related matters in association with the purchase of a technology company.

Also, during the six months ended June 30, 2012, the Company terminated the warrant held by Rusnano as part of the redemption of Rusnano's redeemable noncontrolling interest for its fair value of \$77.



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	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Auction Rate Securities</b>				
Balance, beginning of period	\$ 1,106	\$ 870	\$ 1,104	\$ 921
Period transactions				
Change in fair value	2		4	(51)
Redeemed by issuers at par				
Balance, end of period	\$ 1,108	\$ 870	\$ 1,108	\$ 870
<b>Contingent Purchase Consideration</b>				
Balance, beginning of period	\$ 597	\$ 1,023	\$ 999	\$ 685
Period transactions				282
Adjustment for determination of final payment			987	
Change in fair value		24	28	80
Reclass of determined final payment			(1,417)	
Balance, end of period	\$ 597	\$ 1,047	\$ 597	\$ 1,047
<b>Warrant</b>				
Balance, beginning of period	\$ 77	\$ 180	\$ 77	\$ 180
Period transactions	(77)	(674)	(77)	(674)
Change in fair value		654		654
Balance, end of period	\$	\$ 160	\$	\$ 160

**10. INTANGIBLES**

(In thousands)	June 30, 2012				December 31, 2011			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted- Average Lives	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted- Average Lives
<b>Amortizable intangible assets</b>								
Patents	\$ 4,664	\$ (3,735)	\$ 929	6 Years	\$ 4,664	\$ (3,278)	\$ 1,386	6 Years
Customer relationships	3,479	(1,925)	1,554	5 Years	3,567	(1,619)	1,948	5 Years
Production know-how	2,425	(689)	1,736	9 Years	2,477	(547)	1,930	9 Years
Technology license	1,121	(394)	727	4 Years	1,155	(262)	893	4 Years
	\$ 11,689	\$ (6,743)	\$ 4,946		\$ 11,863	\$ (5,706)	\$ 6,157	

The Company completed an acquisition through its Italian subsidiary in the first quarter of 2011. Consideration included cash payments aggregating \$900 and contingent consideration with an aggregate fair value of \$282. Net assets acquired primarily consisted of intangible assets related to software aggregating \$1,182.

Amortization expense for the three months ended June 30, 2012 and 2011 was \$546 and \$511, respectively. Amortization expense for the six months ended June 30, 2012 and 2011 was \$1,097 and \$1,115, respectively. The estimated future amortization expense for intangibles for the remainder of 2012 and subsequent years is as follows (in thousands):

2012	2013	2014	2015	2016	Thereafter	Total
\$1,250	\$ 1,315	\$ 1,124	\$ 480	\$ 273	\$ 504	\$ 4,946



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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 six months ended June 30, 2012 and 2011:

	<b>2012</b>	<b>2011</b>
Balance at January 1	\$ 8,631	\$ 6,917
Provision for warranty accrual	3,699	3,293
Warranty claims and other reductions	(2,946)	(1,923)
Foreign currency translation	(224)	508
<b>Balance at June 30</b>	<b>\$ 9,160</b>	<b>\$ 8,795</b>

Accrued warranty reported in the accompanying consolidated financial statements as of June 30, 2012 and December 31, 2011 consist of \$6,687 and \$6,186 in accrued expenses and other liabilities and \$2,474 and \$2,445 in other long-term liabilities, respectively.

**12. INCOME TAXES**

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

	<b>2012</b>	<b>2011</b>
Balance at January 1	\$ 4,509	\$ 2,951
Settlements of prior period positions		
Gross decreases tax positions in prior periods		
Gross increases tax positions in prior periods	18	473
<b>Balance at June 30</b>	<b>\$ 4,527</b>	<b>\$ 3,424</b>

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.

**13. COMMITMENTS AND CONTINGENCIES**

In November 2006, IMRA America, Inc. filed an action against the Company alleging that certain products it produces infringe one U.S. patent allegedly owned by IMRA America. IMRA America alleged willful infringement and sought damages, including for alleged lost profits, of at least \$26,000 through June 2011, treble damages, attorneys' fees and injunctive relief. The trial occurred in September and October 2011, and the jury returned a unanimous verdict that the Company did not infringe. IMRA America has filed post-trial motions seeking to set aside the jury verdict. IMRA also has the right to appeal the verdict. The Company believes it has meritorious defenses and will vigorously contest the filed motions and any appeal. No loss was deemed probable at June 30, 2012 and no amounts have been accrued with respect to this contingency.

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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 in diverse end markets. We sell our products globally to original equipment manufacturers, or OEMs, system integrators and end users. We market our products internationally primarily through our direct sales force.

We design and manufacture most of our key components used in our finished products, from semiconductor diodes to optical fibers and other components, 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. Since our formation in 1990, we have been focused on developing and manufacturing high-power fiber lasers and amplifiers.

#### **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.

*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 is generally higher for low, mid-power devices and certain specialty products than for high-power devices 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.

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. In addition, absorption of fixed costs can benefit gross margins due to an increase in production that is not sold and placed into inventory. If both



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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 \$1.8 million and \$1.2 million for the three months ended June, 30, 2012 and 2011, respectively, \$3.6 million and \$2.2 million for the six months ended June, 30, 2012 and 2011, respectively and \$6.1 million, \$2.7 million and \$5.3 million for the years ended December 31, 2011, 2010 and 2009, 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 level of litigation activity.

*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 were 18% for the six months ended June 30, 2012 and 17%, 19% and 12% for the full years 2011, 2010 and 2009, respectively. 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 were to substantially reduce their purchases from us, our results would be adversely affected.

**Results of Operations for the three months ended June 30, 2012 compared to the three months ended June 30, 2011**

*Net sales.* Net sales increased by \$16.0 million, or 13.1%, to \$137.9 million for the three months ended June 30, 2012 from \$121.9 million for the three months ended June 30, 2011.

	Three Months Ended June 30,				Change	
	2012	% of Total	2011	% of Total		
Materials processing	\$ 124,611	90.3%	\$ 107,900	88.5%	\$ 16,711	15.5%
Other applications	13,316	9.7%	14,036	11.5%	(720)	-5.1%
<b>Total</b>	<b>\$ 137,927</b>	<b>100.0%</b>	<b>\$ 121,936</b>	<b>100.0%</b>	<b>\$ 15,991</b>	<b>13.1%</b>

Sales for materials processing applications increased primarily due to higher sales of high power and medium power lasers used in cutting and welding applications and pulsed lasers used in marking and engraving applications. We continue to see increased acceptance of the advantages of fiber laser technology. An increasing number of OEM customers have developed cutting systems that use our high power lasers and sales of these systems are gaining market share from gas laser systems because fiber laser systems cut a more diverse number of metals faster and at a lower cost. In addition, new welding processes using fiber lasers have been developed increasing sales of lasers for this application which are replacing traditional laser and non-laser welding technologies due to the faster welding speeds and improved weld quality. We also increased sales of pulsed lasers used for marking and engraving applications due to increased demand in consumer electronics applications.

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*Cost of sales and gross margin.* Cost of sales increased by \$7.8 million, or 14.1%, to \$63.0 million for the three months ended June 30, 2012 from \$55.2 million for the three months ended June 30, 2011. Our gross margin decreased slightly to 54.3% for the three months ended June 30, 2012 from 54.7% for the three months ended June 30, 2011. Gross margin decreased due to product mix and decreased absorption of manufacturing costs.

*Sales and marketing expense.* Sales and marketing expense increased by \$0.1 million, or 1.7%, to \$5.9 million for the three months ended June 30, 2012 from \$5.8 million for the three months ended June 30, 2011, primarily as a result of an increase in amortization of units used for demonstration purposes. As a percentage of sales, sales and marketing expense decreased to 4.2% for the three months ended June 30, 2012 from 4.8% for the three months ended June 30, 2011.

*Research and development expense.* Research and development expense increased \$0.6 million, or 9.4%, to \$7.2 million for the three months ended June 30, 2012, compared to \$6.6 million for the three months ended June 30, 2011, primarily as a result of an increase in material expenses. Research and development activity continues to focus on enhancing the performance of our internally manufactured components, refining production processes to improve manufacturing yields, the development of new products operating at different wavelengths and higher output powers and new complementary accessories to be used with our products. As a percentage of sales, research and development expense decreased to 5.2% for the three months ended June 30, 2012 from 5.4% for the three months ended June 30, 2011.

*General and administrative expense.* General and administrative expense increased by \$0.4 million, or 4.8%, to \$8.7 million for the three months ended June 30, 2012 from \$8.3 million for the three months ended June 30, 2011, primarily due to consulting expenses and higher bad debt expense. As a percentage of sales, general and administrative expense decreased to 6.3% for the three months ended June 30, 2012 from 6.8% for the three months ended June 30, 2011.

*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 June 30, 2012 would have been \$4.3 million higher, gross profit would have been \$2.3 million higher and total operating expenses would have been \$0.7 million higher.

*Gain on foreign exchange.* We incurred a foreign exchange gain of \$3.4 million for the three months ended June 30, 2012 as compared to \$0.2 million gain for the three months ended June 30, 2011. At the end of the second quarter our primary exposure to foreign exchange risk was due to our net dollar denominated assets held by subsidiaries with a Euro functional currency.

*Interest income (expense), net.* Interest income (expense), net increased to \$0.6 million of income for the three months ended June 30, 2012 compared to \$0.2 million of expense for the three months ended June 30, 2011. The increase of income is the result of increases in interest bearing deposits during the period.

*Provision for income taxes.* Provision for income taxes was \$17.1 million for the three months ended June 30, 2012 compared to \$13.8 million for the three months ended June 30, 2011, representing an effective tax rate of 30.1% and 30.5% for the three months ended June 30, 2012 and 2011, respectively. The increase in the provision for income taxes was primarily the result of increased income before provision for income taxes. The decrease in effective rate was due primarily to the mix of income earned in various tax jurisdictions.

*Net income attributable to IPG Photonics Corporation.* Net income attributable to IPG Photonics Corporation increased by \$7.0 million to \$37.7 million, or 22.8% for the three months ended June 30, 2012 compared to \$30.7 million for the three months ended June 30, 2011. Net income attributable to IPG Photonics Corporation as a percentage of our net sales increased by 2.2 percentage points to 27.4% for the three months ended June 30, 2012 from 25.2% for the three months ended June 30, 2011 due to the factors described above.

**Results of Operations for the six months ended June 30, 2012 compared to the six months ended June 30, 2011**

*Net sales.* Net sales increased by \$39.2 million, or 17.7%, to \$261.1 million for the six months ended June 30, 2012 from \$221.9 million for the three months ended June 30, 2011.

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	Six Months Ended June 30,		2011		Change	
	2012	% of Total		% of Total		
Materials processing	\$ 227,800	87.2%	\$ 194,297	87.6%	\$ 33,503	17.2%
Other applications	33,319	12.8%	27,597	12.4%	5,722	20.7%
<b>Total</b>	<b>\$ 261,119</b>	<b>100.0%</b>	<b>\$ 221,894</b>	<b>100.0%</b>	<b>\$ 39,225</b>	<b>17.7%</b>

Sales for materials processing applications increased primarily due to higher sales of high power and medium power lasers used in cutting and welding applications. We continue to see increased acceptance of the advantages of fiber laser technology. An increasing number of OEM customers have developed cutting systems that use our high power lasers and sales of these systems are gaining market share from gas laser systems because fiber laser systems cut a more diverse number of metals faster and at a lower cost. In addition, new welding processes using fiber lasers have been developed increasing sales of lasers for this application which are replacing traditional laser and non-laser welding technologies due to the faster welding speeds and improved weld quality. The increase in other applications sales relates primarily to an increase in sales of high-power lasers used in advanced applications.

*Cost of sales and gross margin.* Cost of sales increased by \$16.0 million, or 15.8%, to \$117.5 million for the six months ended June 30, 2012 from \$101.5 million for the six months ended June 30, 2011. Our gross margin increased to 55.0% for the six months ended June 30, 2012 from 54.2% for the six months ended June 30, 2011. Gross margin increased due to product mix and increased absorption of manufacturing costs.

*Sales and marketing expense.* Sales and marketing expense increased by \$0.2 million, or 1.8%, to \$11.0 million for the six months ended June 30, 2012 from \$10.8 million for the six months ended June 30, 2011, primarily as a result of an increase in expenses for advertising and trade shows. As a percentage of sales, sales and marketing expense decreased to 4.2% for the six months ended June 30, 2012 from 4.9% for the six months ended June 30, 2011.

*Research and development expense.* Research and development expense increased \$2.1 million, or 16.4%, to \$14.4 million for the six months ended June 30, 2012, compared to \$12.3 million for the six months ended June 30, 2011, primarily as a result of an increase in material expenses and personnel costs. Research and development activity continues to focus on enhancing the performance of our internally manufactured components, refining production processes to improve manufacturing yields, the development of new products operating at different wavelengths and higher output powers and new complementary accessories to be used with our products. As a percentage of sales, research and development expense decreased slightly to 5.5% for the six months ended June 30, 2012 from 5.6% for the six months ended June 30, 2011.

*General and administrative expense.* General and administrative expense increased by \$2.2 million, or 13.2%, to \$18.7 million for the six months ended June 30, 2012 from \$16.5 million for the six months ended June 30, 2011, primarily due to consulting expenses, higher bad debt expense, increased recruitment costs and increased travel expenses. As a percentage of sales, general and administrative expense decreased to 7.2% for the six months ended June 30, 2012 from 7.4% for the six months ended June 30, 2011.

*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 six months ended June 30, 2012 would have been \$5.2 million higher, gross profit would have been \$2.8 million higher and total operating expenses would have been \$0.9 million higher.

*Gain on foreign exchange.* We incurred a foreign exchange gain of \$2.1 million for the six months ended June 30, 2012 as compared to \$0.5 million loss for the six months ended June 30, 2011. At the end of the second quarter our primary exposure to foreign exchange risk was due to our net dollar denominated assets held by subsidiaries with a Euro functional currency.

*Interest income (expense), net.* Interest income (expense), net increased to \$0.5 million of income for the six months ended June 30, 2012 compared to \$0.4 million of expense for the six months ended June 30, 2011. The increase of income is the result of increases in interest bearing deposits during the period.

*Provision for income taxes.* Provision for income taxes was \$30.5 million for the six months ended June 30, 2012 compared to \$24.3 million for the six months ended June 30, 2011, representing an effective tax rate of 30.3% and 30.7% for the six months

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ended June 30, 2012 and 2011, respectively. The increase in the provision for income taxes was primarily the result of increased income before provision for income taxes. The decrease in effective rate was due primarily to the mix of income earned in various tax jurisdictions.

*Net income attributable to IPG Photonics Corporation.* Net income attributable to IPG Photonics Corporation increased by \$13.9 million to \$67.7 million, or 25.7% for the six months ended June 30, 2012 compared to \$53.8 million for the six months ended June 30, 2011. Net income attributable to IPG Photonics Corporation as a percentage of our net sales increased by 1.6 percentage points to 25.8% for the six months ended June 30, 2012 from 24.2% for the six months ended June 30, 2011 due to the factors described above.

**Liquidity and Capital Resources**

Our principal sources of liquidity as of June 30, 2012 consisted of cash and cash equivalents of \$345.6 million, short-term investments of \$9.8 million, unused credit lines and overdraft facilities of \$58.4 million and working capital (excluding cash and short-term investments) of \$143.8 million. This compares to cash and cash equivalents of \$180.2 million, short-term investments of \$25.5 million, unused credit lines and overdraft facilities of \$49.8 million and working capital (excluding cash and short-term investments) of \$135.1 million as of December 31, 2011. The increase in cash and cash equivalents of \$165.4 million from December 31, 2011 relates primarily to net cash received in the follow-on public stock offering of \$168.3 million, net of offering expenses during the first quarter. Also, cash provided by operating activities in the six months ended June 30, 2012 was \$78.5 million. These increases were partially offset by capital expenditures of \$36.0 million and the repurchased redeemable noncontrolling interest of \$55.4 million.

Our long-term debt consists primarily of a \$14.7 million secured variable-rate note, of which \$1.3 million is the current portion. 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 and is currently 5.0%. The note is secured by a mortgage on real estate and buildings that we own in Massachusetts. In January 2011, we entered into a 10 year Euro 1.4 million (\$1.8 million) mortgage obligation to fund the purchase of a new building in Italy, of which \$0.2 million is the current portion. The interest on this mortgage obligation is fixed at 4.96% and it amortizes in full over the term of the obligation. In the first quarter of 2012, we determined the final payment of \$1.8 million relating to the 2010 purchase of a technology company.

In June 2012, our German subsidiary entered into a new credit facility with Deutsche Bank AG (the Euro Credit Facility) to replace the prior credit facility that expired on June 30, 2012. The Euro Credit Facility makes available Euro 20.0 million (\$25.2 million) and will expire on June 30, 2014.

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 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 June 30, 2012:

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 Facility (Germany)(2)	Euro 20.0 million (\$25.2 million)	Euribor + 1.25% or EONIA 1.50%	June 2014	Unsecured, guaranteed by parent company
Euro Overdraft Facilities	Euro 1.9 million (\$2.4 million)	2.4%-6.5%	Between September 2012 and October 2012	Common pool of assets of German and Italian subsidiaries

(1) \$14.1 million of this credit facility is available to our foreign subsidiaries in their respective local currencies, including India, China, Japan and South Korea. Total drawings at June 30, 2012 were \$0.4 million with an interest rate of 1.3%

(2)

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\$16.4 million of this credit facility is available to our German subsidiary, \$3.8 million is available to our Russian subsidiary and \$5.0 million is available to our Italian subsidiary. Total drawing at June 30, 2012 was \$3.4 million with an interest rate of 1.8%.

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Our largest committed credit lines are with Bank of America and Deutsche Bank in the amounts of \$35.0 million and \$25.2 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 June 30, 2012.

The financial covenants in our loan documents may cause us to not take or to delay investments and actions that we might otherwise undertake because of limits on capital expenditures and amounts that we can borrow or lease. In the event that we do not comply with any one of these covenants, we would be in default under the loan agreement or loan agreements, which may result in acceleration of the debt, cross-defaults on other debt or a reduction in available liquidity, any of which could harm our results of operations and financial condition.

In December 2010 and June 2011, we sold a 22.5% minority interest (the *Minority Interest* ) of our Russian subsidiary, NTO IRE-Polus ( *NTO* ), to the Russian Corporation for Nanotechnologies ( *Rusnano* ) for \$45.0 million. In addition, we had a call option commencing in December 2013 to buy back the *Minority Interest* at a predetermined value and *Rusnano* had a warrant to purchase an additional 2.5% interest in *NTO* and a put option commencing in December 2015 to sell its *Minority Interest* to us at a predetermined value. On June 29, 2012, we repurchased the *Minority Interest* for \$55.4 million cash and, under the terms of the agreement, the warrant and the put and call options were terminated. Due to the put rights, the *Minority Interest* was reported as a liability other than permanent equity under ASC 480-10-S99-3A. Based upon our valuation of the *Minority Interest*, the amount paid to repurchase the *Minority Interest* did not exceed its fair value. Accordingly, as per ASC 480-10-S99-3A, we recorded the amount paid in excess of carrying amount in additional paid-in capital.

*Operating activities.* Net cash provided by operating activities increased by \$51.5 million to \$78.5 million for the six months ended June 30, 2012 from \$27.0 million for the six months ended June 30, 2011, primarily resulting from:

An increase in cash provided by net income after adding back non-cash charges of \$9.1 million in the six months ended June 30, 2012 as compared to \$60.8 million in the same period in 2011;

An increase in inventory of \$10.1 million in the six months ended June 30, 2012 compared to an increase of \$35.2 million in the six months ended June 30, 2011;

An increase in income and other taxes payable of \$11.0 million in the six months ended June 30, 2012 compared to an increase of \$1.8 million in the six months ended June 30, 2011; partially offset by

An increase in accounts receivable of \$13.3 million in the six months ended June 30, 2012 compared to an increase of \$16.9 million in the six months ended June 30, 2011.

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.



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*Investing activities.* Net cash used in investing activities was \$20.3 million and \$23.1 million in the six months ended June 30, 2012 and 2011, respectively. The cash used in investing activities in 2012 related to the construction of new buildings in the US, Germany and Russia. These expenditures were partially offset by the proceeds from the maturity of short-term investments of \$15.7 million. In the six months ended June 30, 2011, cash used in investing activities was related to the purchase of new buildings in Germany and Japan and start of the construction of new buildings in Russia.

We expect to incur approximately \$60.0 million in capital expenditures in 2012. 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 \$111.0 million and \$29.7 million in the six months ended June 30, 2012 and 2011, respectively. The cash provided by financing activities in 2012 was primarily related to the follow-on public stock offering for which we received \$168.0 million, net of offering expenses partially offset by the repurchased 22.5% redeemable noncontrolling interest in our Russian subsidiary of \$55.4 million. The cash provided by financing activities in 2011 was primarily related to cash received from Rusnano for a 10% interest in our Russian subsidiary and cash provided by the exercise of stock options and issuances under our employee stock purchase plan.

### **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, 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, 2011. 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**

In June 2011, FASB issued Accounting Standards Updates No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, ( ASU No. 2011-05 ) which amends current comprehensive income guidance. This accounting update eliminated the option to present the components of other comprehensive income as part of the statement of stockholders' equity. Instead, we must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. We adopted ASU 2011-05 in the first quarter of 2012. This adoption did not have an impact on the statement of financial condition as it only required a change in the ordering of our financial statements.

### **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



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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.

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 interest rate swap agreements. 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 Japanese Yen and the Russian Ruble. Gains on foreign exchange transactions totaled \$3.3 million and \$0.2 million for the three months ended June 30, 2012 and 2011, respectively. Management believes that the use of foreign currency hedging instruments reduces the risks of certain foreign currency transactions; however, these instruments provide only limited protection. We have no foreign currency hedges as of June 30, 2012, however, 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.

## **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 in the second quarter of 2012 with respect to those proceedings previously reported in our Annual Report on Form 10-K for the year ended December 31, 2011.

### **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, 2011, 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**

None.



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**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

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**ITEM 6. EXHIBITS**

(a) Exhibits

<b>Exhibit No.</b>	<b>Description</b>
12.1	Statement Re Computation of Earnings to Fixed Charges
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: August 3, 2012

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

Date: August 3, 2012

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