

IPG PHOTONICS CORP  
Form 10-Q  
August 09, 2010

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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 June 30, 2010**

**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  
(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 ☐

(Do not check if a 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 August 04, 2010, there were 46,306,007 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**

	June 30, 2010	December 31, 2009
	(In thousands, except share and per share data)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 90,655	\$ 82,920
Accounts receivable, net	39,907	30,356
Inventories, net	54,029	52,869
Income taxes receivable	2,960	2,558
Prepaid expenses and other current assets	7,191	4,653
Deferred income taxes	10,137	7,558
Total current assets	204,879	180,914
DEFERRED INCOME TAXES	5,326	4,313
PROPERTY, PLANT AND EQUIPMENT, Net	106,106	111,453
OTHER ASSETS	17,413	15,956
TOTAL	\$ 333,724	\$ 312,636
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Revolving line-of-credit facilities	\$ 6,300	\$ 6,007
Current portion of long-term debt	1,333	1,333
Accounts payable	10,427	5,620
Accrued expenses and other liabilities	35,287	21,189
Deferred income taxes	2,572	503
Income taxes payable	7,408	2,179
Total current liabilities	63,327	36,831
DEFERRED INCOME TAXES AND OTHER LONG-TERM LIABILITIES	1,425	2,567
LONG-TERM DEBT	16,649	16,667
COMMITMENTS AND CONTINGENCIES		
IPG PHOTONICS CORPORATION STOCKHOLDERS' EQUITY:		
Common stock, \$0.0001 par value, 175,000,000 shares authorized; 46,302,938 shares issued and outstanding at June 30, 2010; 46,076,472 shares issued and outstanding at December 31, 2009	5	5

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Additional paid-in capital	296,572	293,743
Accumulated deficit	(34,721)	(48,424)
Accumulated other comprehensive (loss) income	(9,740)	11,106
Total IPG Photonics Corporation stockholders' equity	252,116	256,430
NONCONTROLLING INTERESTS	207	141
Total equity	252,323	256,571
TOTAL	\$ 333,724	\$ 312,636

See notes to consolidated financial statements.

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**IPG PHOTONICS CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(In thousands, except per share data)			
NET SALES	\$ 67,258	\$ 40,385	\$ 118,462	\$ 85,793
COST OF SALES	36,797	28,613	67,454	58,160
GROSS PROFIT	30,461	11,772	51,008	27,633
OPERATING EXPENSES:				
Sales and marketing	4,932	3,880	9,270	7,069
Research and development	4,729	4,734	8,887	8,876
General and administrative	7,384	4,944	14,212	9,934
(Gain) loss on foreign exchange	(2,295)	(500)	(2,403)	1,015
Total operating expenses	14,750	13,058	29,966	26,894
OPERATING INCOME (LOSS)	15,711	(1,286)	21,042	739
OTHER EXPENSE, NET:				
Interest expense	(191)	(367)	(399)	(757)
Other expense	(26)	(36)	(92)	(184)
Total other expense	(217)	(403)	(491)	(941)
INCOME (LOSS) BEFORE (PROVISION FOR) BENEFIT FROM INCOME TAXES	15,494	(1,689)	20,551	(202)
(PROVISION FOR) BENEFIT FROM INCOME TAXES	(5,149)	524	(6,782)	63
NET INCOME (LOSS)	10,345	(1,165)	13,769	(139)
LESS: NET INCOME (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS	39	64	66	(181)
NET INCOME (LOSS) ATTRIBUTABLE TO IPG PHOTONICS CORPORATION	\$ 10,306	\$ (1,229)	\$ 13,703	\$ 42
NET INCOME (LOSS) ATTRIBUTABLE TO IPG PHOTONICS CORPORATION PER SHARE:				
CORPORATION PER SHARE:				
Basic	\$ 0.22	\$ (0.03)	\$ 0.30	\$ 0.00
Diluted	\$ 0.22	\$ (0.03)	\$ 0.29	\$ 0.00

WEIGHTED-AVERAGE SHARES OUTSTANDING:

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Basic	46,220	45,431	46,159	45,263
Diluted	47,333	45,431	47,262	46,336

See notes to consolidated financial statements.

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**IPG PHOTONICS CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(In thousands)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 13,769	\$ (139)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	10,514	9,043
Deferred income taxes	(2,766)	(5,699)
Stock-based compensation	1,563	1,205
Unrealized (gains) losses on foreign currency transactions	(2,403)	1,015
Other	(51)	(20)
Provisions for inventory, warranty and bad debt	4,475	6,152
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	(12,740)	8,197
Inventories	(9,515)	1,686
Prepaid expenses and other current assets	391	398
Accounts payable	4,191	(335)
Accrued expenses and other liabilities	13,237	(406)
Income and other taxes payable	2,773	2,703
Net cash provided by operating activities	23,438	23,800
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant, equipment and intangible assets	(8,701)	(7,726)
Acquisition of businesses, net of cash acquired	(4,108)	
Other	117	(54)
Net cash used in investing activities	(12,692)	(7,780)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from line-of-credit facilities	5,543	16,502
Payments on line-of-credit facilities	(5,033)	(4,716)
Purchases of noncontrolling interests		(508)
Principal payments on long-term borrowings	(667)	(677)
Exercise of employee stock options, issuances under employee stock purchase plan and related tax benefit from exercise	1,266	477
Net cash provided by financing activities	1,109	11,078
<b>EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>	(4,120)	(313)
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	7,735	26,785
<b>CASH AND CASH EQUIVALENTS Beginning of period</b>	82,920	51,283

CASH AND CASH EQUIVALENTS	End of period	\$ 90,655	\$ 78,068
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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid for interest		\$ 515	\$ 794
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Income taxes paid		\$ 3,504	\$ 5,059
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Non-cash transactions:

Amounts related to acquisition of businesses included in accounts payable and accrued expenses and other liabilities		\$ 1,478	\$
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Additions to property, plant and equipment included in accounts payable		\$ 286	\$ 360
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Demonstration units transferred from inventory to other assets		\$ 652	\$ 3,196
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Purchases of noncontrolling interests in exchange for Common Stock		\$	\$ 3,027
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Inventory contributed to unconsolidated affiliate		\$	\$ 237
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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,			
	2010		2009	
	(In thousands, except share and per share data)			
	Shares	Amount	Shares	Amount
COMMON STOCK				
Balance, beginning of year	46,076,472	\$ 5	44,965,960	\$ 4
Exercise of stock options	201,637		158,049	
Common stock issued under employee stock purchase plan	24,829		24,076	
Common stock issued in purchase of noncontrolling interests			368,146	1
Balance, end of period	46,302,938	5	45,516,231	5
ADDITIONAL PAID-IN CAPITAL				
Balance, beginning of year		293,743		283,217
Stock-based compensation		1,563		1,205
Exercise of stock options and related tax benefit from exercise		945		253
Common stock issued under employee stock purchase plan		321		224
Common stock issued in purchase of noncontrolling interests				3,027
Discount on purchase of noncontrolling interests				2,028
Premium on purchase of noncontrolling interests				(712)
Balance, end of period		296,572		289,242
ACCUMULATED DEFICIT				
Balance, beginning of year		(48,424)		(53,843)
Net income attributable to IPG Photonics Corporation		13,703		42
Balance, end of period		(34,721)		(53,801)
ACCUMULATED OTHER COMPREHENSIVE INCOME				
Balance, beginning of year		11,106		8,794
Translation adjustments		(20,664)		(446)
Unrealized (loss) gain on derivatives, net of tax		(182)		335
Balance, end of period		(9,740)		8,683

TOTAL IPG PHONTONICS CORPORATION STOCKHOLDERS EQUITY	252,116	244,129
NONCONTROLLING INTERESTS		
Balance, beginning of year	141	5,127
Net income (loss) attributable to noncontrolling interests	66	(181)
Purchase of noncontrolling interests		(3,535)
Premium on purchase of noncontrolling interests		712
Discount on purchase of noncontrolling interests		(2,028)
Balance, end of period	207	95
TOTAL EQUITY	\$ 252,323	\$ 244,224

See notes to consolidated financial statements.

**Table of Contents****IPG PHOTONICS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. BASIS OF PRESENTATION**

The accompanying unaudited interim consolidated financial statements have been prepared by IPG Photonics Corporation, or IPG, we, our, or the Company. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The consolidated financial statements include our accounts and those of our 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 our annual report on Form 10-K for the year ended December 31, 2009.

Effective January 1, 2010, the functional currency of our Russian subsidiary changed from the U.S. Dollar to the Russian Ruble due to other than temporary changes in the business that made the local currency the predominate transactional currency. As a result of this change in functional currency, the Company was required to change the method of translation of the financial statements of this business into U.S. dollars. From the effective date forward, the Company translates all assets and liabilities of the business into U.S. dollars using the exchange rate at the end of the period, income statement items are translated using rates at the date that the transactions are recorded, and related translation adjustments are accumulated and charged to accumulated other comprehensive income.

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

We have evaluated subsequent events through the time of filing this Quarterly Report on Form 10-Q with the SEC.

**2. RECENT ACCOUNTING PRONOUNCEMENTS**

In October 2009, an update was issued to the accounting guidance related to the separation criteria used to determine the unit of accounting for multiple element arrangements. This update removes the objective-and-reliable-evidence-of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, replaces references to fair value with selling price to distinguish from the fair value measurements required under the *Fair Value Measurements and Disclosures* guidance, provides a hierarchy that entities must use to estimate the selling price, eliminates the use of the residual method for allocation and expands the ongoing disclosure requirements. This guidance is effective for us beginning January 1, 2011, although early adoption is permitted, and adoption can be applied prospectively or retrospectively. We are evaluating the effect that implementation of this update will have, if any, on our consolidated financial position and results of operations upon adoption.

**3. INVENTORIES**

Inventories consist of the following (in thousands):

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Components and raw materials	\$ 17,605	\$ 17,801
Work-in-process	21,240	21,375
Finished goods	15,184	13,693
 Total	 \$ 54,029	 \$ 52,869

The Company recorded inventory provisions totaling \$1.4 million and \$4.2 million for the six months ended June 30, 2010 and 2009, respectively. These provisions were recorded as a result of changes in market prices of

certain components, the realizable value of those inventories through finished product sales and uncertainties related 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.

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The Company's borrowings under existing financing arrangements consist of the following (in thousands):

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Revolving Line-of-Credit Facilities:		
Euro Credit and Overdraft Facilities	\$ 1,567	\$ 977
U.S. Line of Credit	4,733	5,030
 Total	 \$ 6,300	 \$ 6,007
 Term Debt:		
U.S. Long-Term Note	17,333	18,000
Other Notes payable	649	
Less current portion	(1,333)	(1,333)
Total long-term debt	\$ 16,649	\$ 16,667

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

**5. 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 (in thousands, except per share data):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net income attributable to IPG Photonics Corporation	\$ 10,306	\$ (1,229)	\$ 13,703	\$ 42
Weighted average shares	46,220	45,431	46,159	45,263
Dilutive effect of common stock equivalents	1,113		1,103	1,073
 Diluted weighted average common shares	 47,333	 45,431	 47,262	 46,336
 Basic net income attributable to IPG Photonics Corporation per share	 \$ 0.22	 \$ (0.03)	 \$ 0.30	 \$ 0.00
 Diluted net income attributable to IPG Photonics Corporation per share	 \$ 0.22	 \$ (0.03)	 \$ 0.29	 \$ 0.00

The computation of diluted weighted average common shares excludes options to purchase 373,000 shares for the three months and six months ended June 30, 2010 and 1,153,000 shares for the six months ended June 30, 2009, because these options were out-of-the-money. The computation of diluted weighted average common shares excludes options to purchase 2,240,000 shares for the three months ended June 30, 2009, because the effect on net income

attributable to IPG Photonics Corporation per share would have been anti-dilutive as a result of the Company's net loss during the period.

**6. COMPREHENSIVE INCOME**

Total comprehensive (loss) income and its components were as follows (in thousands):

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	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net income (loss) attributable to IPG Photonics Corporation	\$ 10,306	\$ (1,229)	\$ 13,703	\$ 42
Other comprehensive (loss) income:				
Unrealized (gain) loss on secured note interest rate swap	(110)	304	(182)	335
Foreign currency translation adjustment	(12,213)	6,493	(20,664)	(446)
Comprehensive (loss) income	\$ (2,017)	\$ 5,568	\$ (7,143)	\$ (69)

## 7. DERIVATIVE FINANCIAL INSTRUMENTS

Our primary market exposures are to interest rates and foreign exchange rates. We use certain derivative financial instruments to help manage these exposures. We execute these instruments with financial institutions we judge to be credit-worthy. We do not hold or issue derivative financial instruments for trading or speculative purposes.

We recognize all derivative financial instruments as either assets or liabilities at fair value in the consolidated balance sheet. We have used foreign currency forward contracts as cash flow hedges of forecasted intercompany settlements denominated in foreign currencies of major industrial countries. We have no outstanding foreign currency forward contracts. We have an interest rate swap that is classified as a cash flow hedge of our variable rate debt. We have no derivatives that are not accounted for as a hedging instrument.

*Cash flow hedges* - Our cash flow hedge is an interest rate swap under which we agree to pay fixed rates of interest. The fair value amounts in the consolidated balance sheet were (in thousands):

	<b>Notional Amounts<sup>1</sup></b>		<b>Other Assets</b>		<b>Other Long-Term Liabilities</b>	
	<b>June 30, 2010</b>	<b>December 31, 2009</b>	<b>June 30, 2010</b>	<b>December 31, 2009</b>	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Interest rate swap	\$ 17,333	\$ 18,000	\$	\$	\$ 1,420	\$ 1,125
Total	\$ 17,333	\$ 18,000	\$	\$	\$ 1,420	\$ 1,125

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

We made no adjustments to the fair value of this derivative as a result of evaluating counterparty risk.

The derivative gains (losses) in the consolidated statement of operations related to our interest rate swap contract were as follows (in thousands):

	<b>Six Months Ended June 30,</b>		<b>Three Months Ended June 30</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Effective portion recognized in other comprehensive (loss) gain, pretax:				
Interest rate swap	\$ 51	\$ 863	\$ (5)	\$ 663

Effective portion reclassified from other comprehensive  
(loss) gain to interest expense, pretax:

Interest rate swap	\$(346)	\$(326)	\$(173)	\$(175)
Ineffective portion recognized in income:				
Interest rate swap	\$	\$	\$	\$

## 8. FAIR VALUE MEASUREMENTS

The following tables present our assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009, and are categorized using the fair value hierarchy. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value. Level 1 refers to fair values determined based on quoted prices in active markets for identical assets. Level 2 refers to fair values estimated using significant other observable inputs, and Level 3 includes fair values estimated using significant non-observable inputs.

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		<b>Fair Value Measurements at June 30, 2010</b>		
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>				
Money market funds	\$ 3,840	\$ 3,840	\$	\$
Treasury bills	40,683	40,683		
German Treasury bills				
Auction rate securities	1,284			1,284
<b>Total assets</b>	<b>\$ 45,807</b>	<b>\$ 44,523</b>	<b>\$</b>	<b>\$ 1,284</b>
<b>Liabilities</b>				
Interest rate swap	\$ 1,420	\$	\$ 1,420	\$
<b>Total liabilities</b>	<b>\$ 1,420</b>	<b>\$</b>	<b>\$ 1,420</b>	<b>\$</b>

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	<b>Fair Value Measurements at December 31, 2009</b>			
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>				
Money market funds	\$ 9,431	\$ 9,431	\$	\$
Treasury bills	28,678	28,678		
German Treasury bills	4,299	4,299		
Auction rate securities	1,284			1,284
<b>Total assets</b>	<b>\$ 43,692</b>	<b>\$ 42,408</b>	<b>\$</b>	<b>\$ 1,284</b>
<b>Liabilities</b>				
Interest rate swap	\$ 1,125	\$	\$ 1,125	\$
<b>Total liabilities</b>	<b>\$ 1,125</b>	<b>\$</b>	<b>\$ 1,125</b>	<b>\$</b>

The fair value of the auction rate securities was estimated utilizing a discounted cash flow analysis. The discounted cash flow analysis considered, among other items, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. The auction rate securities were also compared to other observable market data with similar characteristics to the securities held by the Company.

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	<b>June 30, 2010</b>	<b>December 31, 2009</b>
(In thousands)		
Amortizable intangible assets		
Patents	\$ 4,643	\$ 3,650
Customer relationships	3,377	1,934
Production know-how	2,374	
Other identifiable intangibles	30	109
	10,424	5,693
Accumulated amortization	(2,581)	(1,922)
	\$ 7,843	\$ 3,771

The company completed two acquisitions in the six months ended June 30, 2010, one in the U.S. in the first quarter and one in Germany in April 2010. Amounts paid include cash payments aggregating \$4.6 million and contingent consideration and seller provided financing with an aggregate fair value of \$1.0 million. Net assets acquired primarily consisted of intangible assets (patents, customer relationships, and production know-how with weighted-average estimated useful lives of 10 years, 5 years and 8 years, respectively) aggregating \$5.2 million.

The estimated future amortization expense for intangibles as of June 30, 2010 for the remainder of 2010 and subsequent years is as follows (in thousands):

<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>Thereafter</b>
\$953	\$1,906	\$1,623	\$997	\$760	\$1,604

**10. PRODUCT WARRANTIES**

The company typically provides one to three-year parts and service warranties on lasers and amplifiers. Most of the 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, 2010 and 2009 (in thousands).

	<b>2010</b>	<b>2009</b>
Beginning balance January 1	\$ 3,886	\$ 3,223
Additions for current year deliveries	2,384	1,206
Reductions for services provided	(1,490)	(874)
Impact of foreign currency fluctuation	(354)	3
Ending balance June 30	\$ 4,426	\$ 3,558

**11. COMMITMENTS AND CONTINGENCIES**

In November 2006, the Company was sued for patent infringement relating to certain products, including but not limited to fiber lasers and fiber amplifiers. The plaintiff filed a complaint for damages of over \$10 million, treble damages for alleged willful infringement and injunctive relief. A trial is planned for 2010. The Company believes it has meritorious defenses and intends to vigorously contest the claims. No loss is deemed probable at June 30, 2010 and no amounts have been accrued in respect of this contingency.

In February 2008, the Company was sued for patent infringement relating to two product lines used in medical laser applications. This case settled by mutual agreement in July 2010. The settlement has no material impact upon the Company's financial results.

We are currently undergoing an examination by the German tax authorities for the years 2003 to 2008. We expect that this examination will be completed during the third quarter of 2010. We expect to be able to settle the examination for amounts less than those accrued for uncertain tax positions.

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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 for diverse applications in numerous markets. Our diverse lines of low, mid and high-power lasers and amplifiers are used in materials processing, advanced, communications and medical applications. 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 and also through agreements with independent sales representatives and distributors.

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. 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.* Our net sales have historically fluctuated from quarter to quarter. The increase or decrease in sales from a prior quarter can be affected by the timing of orders received from customers, the shipment, installation and acceptance of products at our customers' facilities, the mix of OEM orders and one-time orders for products with large purchase prices, and seasonal factors such as the purchasing patterns and levels of activity throughout the year in the regions where we operate. Historically, our net sales have been higher in the second half of the year than in the first half of the year. Furthermore, net sales can be affected by the time taken to qualify our products for use in new applications in the end markets that we serve. The adoption of our products by a new customer or qualification in a new application can lead to an increase in net sales for a period, which may then slow until we further penetrate new markets or obtain new customers. Our net sales can also be affected from quarter to quarter by the general level of worldwide economic activity, including economic expansion or contraction, and expenditures on capital equipment. In general, increases in worldwide economic activity have a positive effect on our sales and decreases in economic activity have a negative effect on our sales.

*Gross margin.* Our total gross margin in any period can be affected by total net sales in any period, product mix, that is, the percentage of our revenue in that period that is attributable to higher or lower-power products, production volumes, changes to the sales prices of our products in response to the competitive environment 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 higher for low-power and mid-power devices than for high-power devices. 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.

Due to the fact that a high proportion of our costs are fixed, 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 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 sales and inventory decrease in the same period, the decline in gross margin may be magnified if we cannot reduce fixed costs or choose not to reduce fixed costs to match the decrease in the level of production. We also regularly review our inventory for items that are slow-moving, have been rendered obsolete or determined to be excess. 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.

*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,



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increase the number of units used 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 and products. We plan to increase the personnel involved in research and development and expect to increase other research and development expenses. As such, we expect that our research and development expenses will increase in the aggregate.

*General and administrative expense.* We expect our general and administrative expenses to increase moderately as we continue to invest in systems and resources to support our worldwide operations. Legal expenses vary from quarter to quarter based upon the stage of litigation, including patent re-examinations and termination of litigation stays but could increase in response to any future litigation or due to a change in status of current intellectual property matters. The timing and amount of legal expenses may vary substantially from quarter to quarter.

*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 annual net sales were 17% for the six months ended June 30, 2010, 12% in 2009, 17% in 2008 and 20% in 2007. We seek to add new customers and to expand our relationships with existing customers. We anticipate that the composition of our net sales to 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. Our sales have been affected recently by a substantial reduction in purchases of pulsed lasers from several customers, including one that was formerly our largest customer for several years.

### **Results of Operations for the three months ended June 30, 2010 compared to the three months ended June 30, 2009**

*Net sales.* Net sales increased by \$26.9 million, or 66.5%, to \$67.3 million for the three months ended June 30, 2010 from \$40.4 million for the three months ended June 30, 2009. The growth in net sales was attributable to an increase in sales of fiber lasers used in materials processing applications, where net sales increased by \$27.3 million or 90.8%, and medical applications, where net sales increased by \$0.6 million or 31.9%. These increases were partially offset by a decrease in sales of fiber amplifiers for communications applications, where net sales decreased by \$0.7 million or 24.2%, and a decrease in sales of fiber lasers used in advanced applications, where net sales decreased by \$0.3 million, or 5.3%. The increase in materials processing applications sales resulted from substantially increased sales of pulsed lasers used in marking and engraving applications and high-power lasers used in cutting applications. The increase in medical application sales is due to increased demand from our established customer in the U.S. and new OEM customers in Germany and Asia. The decrease in communications applications sales resulted primarily from decreased sales of amplifiers, particularly in Russia. The decrease in sales of advanced applications was due to lower sales of high-power lasers used in government applications. Sales increases were strong in all geographic regions with increases in excess of 30% in each region. Sales in China were particularly strong for the three months ended June 30, 2010 with an increase of \$9.9 million or 258% compared to the three months ended June 30, 2009, resulting from increased demand for pulsed and high power lasers and an expanded product line offering.

*Cost of sales and gross margin.* Cost of sales increased by \$8.2 million, or 28.6%, to \$36.8 million for the three months ended June 30, 2010 from \$28.6 million for the three months ended June 30, 2009. Our gross margin increased to 45.3% for the three months ended June 30, 2010 from 29.1% for the three months ended June 30, 2009. The increase in gross margin was the result of an increase in net sales and more favorable absorption of our fixed manufacturing costs due to an increase in production volume. In addition, cost of sales benefited from a reduction in the cost per watt of our diodes and a decrease in the cost of internally manufactured accessories. Expenses related to inventory reserves and other valuation adjustments decreased by \$0.7 million to \$0.8 million, or 1.2% of sales for the three months ended June 30, 2010 as compared to \$1.5 million, or 3.7%, of sales for the three months ended June 30, 2009.

*Sales and marketing expense.* Sales and marketing expense increased by \$1.0 million, or 27.1%, to \$4.9 million for the three months ended June 30, 2010 from \$3.9 million for the three months ended June 30, 2009, primarily as a result of an increase in personnel costs due to an increase in headcount and bonus accruals and, to a lesser extent, an

increase in travel expenses. As a percentage of sales, sales and marketing expense decreased to 7.3% for the three months ended June 30, 2010 from 9.6% for the three months ended June 30, 2009.

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*Research and development expense.* Research and development expense was \$4.7 million for the three months ended June 30, 2010 consistent with \$4.7 million for the three months ended June 30, 2009. 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 7.0% for the three months ended June 30, 2010 from 11.7% for the three months ended June 30, 2009.

*General and administrative expense.* General and administrative expense increased by \$2.5 million, or 49.4%, to \$7.4 million for the three months ended June 30, 2010 from \$4.9 million for the three months ended June 30, 2009, primarily due to legal fees related to a patent infringement lawsuit and to a lesser extent an increase in personnel costs due to an increase in accruals related to bonuses. We expect that legal fees will continue at high quarterly levels while the lawsuit is pending. Bonus accruals increased due to an improvement in our financial results. As a percentage of sales, general and administrative expense decreased to 11.0% for the three months ended June 30, 2010 from 12.2% for the three months ended June 30, 2009.

*Effect of exchange rates on sales, gross margin and operating expenses.* We estimate that if exchange rates had been the same as one year ago, sales in 2010 would have been \$2.6 million higher, gross margin would have been \$1.4 million higher and operating expenses in total would have been \$0.1 million higher.

*(Gain) loss on foreign exchange.* We incurred a foreign exchange gain of \$2.3 million (approximately \$0.03 per share) for the three months ended June 30, 2010 as compared to \$0.5 million (approximately \$0.01 per share) for the three months ended June 30, 2009. At the end of the second quarter our primary exposure to foreign exchange risk was our net dollar denominated assets in subsidiaries with a Euro functional currency.

*Interest expense.* Interest expense was \$0.2 million for the three months ended June 30, 2010 compared to \$0.4 million for the three months ended June 30, 2009. The decrease in interest expense, net relates to higher cash levels and lower drawings on credit lines.

*Provision for income taxes.* Provision for income taxes was \$5.1 million for the three months ended June 30, 2010 compared to a benefit of \$0.5 million for the three months ended June 30, 2009, representing an effective tax rate of 33.2% and 31.0% for the three months ended June 30, 2010 and 2009, respectively. The increase in effective rate was due primarily to the mix of income earned in various tax jurisdictions as well as an increase in the effective tax rate in China as a number of uncertain tax positions were settled.

*Net income attributable to IPG Photonics Corporation.* Net income attributable to IPG Photonics Corporation increased by \$11.5 million to \$10.3 million for the three months ended June 30, 2010 compared to a loss of \$1.2 million for the three months ended June 30, 2009. Net income attributable to IPG Photonics Corporation as a percentage of our net sales increased by 18.3 percentage points to 15.3% for the three months ended June 30, 2010 from a loss of 3.0% for the three months ended June 30, 2009 due to the factors described above.

### **Results of Operations for the six months ended June 30, 2010 compared to the six months ended June 30, 2009**

*Net sales.* Net sales increased by \$32.7 million, or 38.1%, to \$118.5 million for the six months ended June 30, 2010 from \$85.8 million for the six months ended June 30, 2009. The growth in net sales was attributable to an increase in sales of fiber lasers used in materials processing applications, where net sales increased by \$35.2 million or 54.4%, and medical applications, where net sales increased by \$1.7 million or 62.8%. These increases were partially offset by a decrease in sales of fiber lasers used in advanced applications, where net sales decreased by \$2.8 million, or 21.5%, and a decrease in sales of fiber amplifiers for communications applications, where net sales decreased by \$1.5 million or 27.3%. The increase in materials processing applications sales resulted from substantially increased sales of pulsed lasers used in marking and engraving applications and high power lasers used in cutting applications. The increase in medical application sales is due to increased demand from our established customer in the U.S. The decrease in communications applications sales resulted primarily from decreased sales of amplifiers, particularly in Russia. The decrease in sales of advanced applications was due to lower sales of high-power lasers used in government applications. Sales increases were strong in all geographic regions with increases in excess of 10% in all geographies. Sales in China were particularly strong for the six months ended June 30, 2010 with an increase of \$12.9 million or 182% compared to the three months ended June 30, 2009, resulting from increased demand for pulsed and high power

lasers and an expanded product line offering.

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*Cost of sales and gross margin.* Cost of sales increased by \$9.3 million, or 16.0%, to \$67.5 million for the six months ended June 30, 2010 from \$58.2 million for the six months ended June 30, 2009. Our gross margin increased to 43.1% for the six months ended June 30, 2010 from 32.2% for the six months ended June 30, 2009. The increase in gross margin was the result of an increase in net sales and more favorable absorption of our fixed manufacturing costs due to an increase in production volume. In addition, cost of sales benefited from a reduction in the cost per watt of our diodes and a decrease in the cost of internally manufactured accessories. Expenses related to inventory reserves and other valuation adjustments decreased by \$2.8 million to \$1.4 million, or 1.2% of sales for the six months ended June 30, 2010 as compared to \$4.2 million, or 4.9%, of sales for the six months ended June 30, 2009.

*Sales and marketing expense.* Sales and marketing expense increased by \$2.2 million, or 31.2%, to \$9.3 million for the six months ended June 30, 2010 from \$7.1 million for the six months ended June 30, 2009, primarily as a result of an increase in personnel costs due to an increase in headcount and bonus accruals and, to a lesser extent, an increase in depreciation expense related to products used for demonstration purposes. As a percentage of sales, sales and marketing expense decreased to 7.8% for the six months ended June 30, 2010 from 8.2% for the six months ended June 30, 2009.

*Research and development expense.* Research and development expense was \$8.9 million for the six months ended June 30, 2010 consistent with \$8.9 million for the six months ended June 30, 2009. 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 used with our products. As a percentage of sales, research and development expense decreased to 7.5% for the six months ended June 30, 2010 from 10.3% for the six months ended June 30, 2009.

*General and administrative expense.* General and administrative expense increased by \$4.3 million, or 43.1%, to \$14.2 million for the six months ended June 30, 2010 from \$9.9 million for the six months ended June 30, 2009, primarily due to legal fees related to a patent infringement lawsuit and to a lesser extent an increase in personnel costs due to an increase in accruals related to bonuses. We expect that legal fees will continue at high quarterly levels while the lawsuit is pending. Bonus accruals increased due to an improvement in our financial results. As a percentage of sales, general and administrative expense increased to 12.0% for the six months ended June 30, 2010 from 11.6% for the six months ended June 30, 2009.

*Effect of exchange rates on Sales, Gross Margin and Operating Expenses.* We estimate that if exchange rates had been the same as one year ago, sales for the six months ended June 30, 2010 would have been \$1.4 million higher, gross margin would have been \$1.1 million higher and operating expenses in total would have been \$0.4 million lower.

*Gain (Loss) on foreign exchange.* Gain (Loss) on foreign exchange increased by \$3.4 million to a gain of \$2.4 million (approximately \$0.03 per share) for the six months ended June 30, 2010 from a loss of \$1.0 million (approximately \$0.01 per share) for the six months ended June 30, 2009 and was primarily attributable to the depreciation of the Euro against the U.S. Dollar.

*Interest expense.* Interest expense was \$0.4 million for the six months ended June 30, 2010 compared to \$0.8 million for the six months ended June 30, 2009. The change in interest expense resulted from higher cash balances and lower utilization of credit lines.

*Provision for income taxes.* Provision for income taxes was \$6.8 million for the six months ended June 30, 2010 compared to a benefit of \$63,000 for the six months ended June 30, 2009, representing an effective tax rate of 33.0% and 31.2% for the six months ended June 30, 2010 and 2009, respectively. The increase in effective rate was due primarily to the mix of income earned in various tax jurisdictions as well as an increase in the effective tax rate in China as a number of uncertain tax positions were settled.

*Net income attributable to IPG Photonics Corporation.* Net income attributable to IPG Photonics Corporation increased by \$13.7 million to \$13.7 million for the six months ended June 30, 2009 from \$42,000 for the six months ended June 30, 2008. Net income attributable to IPG Photonics Corporation as a percentage of our net sales increased by 11.5 percentage points to 11.6% for the six months ended June 30, 2010 from 0.1% for the six months ended June 30, 2009 due to the factors described above.



**Table of Contents****Liquidity and Capital Resources**

Our principal sources of liquidity as of June 30, 2010 consisted of cash and cash equivalents of \$90.7 million, unused credit lines and overdraft facilities of \$51.1 million and working capital (excluding cash) of \$50.9 million. This compares to cash and cash equivalents of \$82.9 million, unused credit lines and overdraft facilities of \$54.3 million and working capital (excluding cash) of \$61.2 million as of December 31, 2009. The increase in cash and cash equivalents of \$7.7 million from December 31, 2009 relates primarily to cash provided by operating activities in the six months ended June 30, 2010 of \$23.4 million, offset by cash outflows related to capital expenditures of \$8.7 million and acquisitions of businesses of \$4.1 million.

Our long-term debt consists of a \$17.3 million secured variable-rate note, of which \$1.3 million is the current portion. This note matures in July 2013, at which time the outstanding debt balance would be \$13.2 million. The interest rate on this debt is fixed by means of an interest rate swap. The note is secured by a mortgage on real estate and buildings that we own in Massachusetts.

We expect that the existing cash and marketable securities, our cash flows from operations and our existing lines of credit will be sufficient to meet our liquidity and capital needs for the foreseeable future. Our future long-term capital requirements will depend on many factors including our level of sales, the impact of economic recessions on our sales levels, the timing and extent of spending to support development efforts, the expansion of our 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. We have made no arrangements to obtain additional financing, and there is no assurance that such additional financing, if required or desired, will be available in amounts or on terms acceptable to us, if at all.

The following table details our line-of-credit facilities as of June 30, 2010:

<b>Description</b>	<b>Available Principal</b>	<b>Interest Rate</b>	<b>Maturity</b>	<b>Security</b>
U.S. Revolving Line of Credit (1)	Up to \$35 million	LIBOR plus 0.8% to 1.2%, depending on our performance	July 2011	Unsecured
Euro Credit Facility (Germany)(2)	Euro 15.0 million (\$18.3 million)	Euribor + 1.0% or EONIA + 1.5%	June 2012	Unsecured, guaranteed by parent company
Euro Overdraft Facilities (3)	Euro 2.5 million (\$3.0 million)	2.8%-6.5%	Between July 2010 and February 2011	Common pool of assets of German and Italian subsidiaries

(1) \$15.0 million of this credit facility is available to foreign subsidiaries in local currencies, including India, China, Japan and Korea.

Total drawings  
at June 30, 2010  
were  
\$4.7 million  
with a weighted  
average interest  
rate of 4.2%



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(2) \$4.0 million of this credit facility is available to our Russian subsidiary and \$1.3 million is available to our Italian subsidiary

(3) \$0.8 million credit facility in Italy expiring in July 2010 was renewed for another year

Our largest committed credit lines are with Bank of America and Deutsche Bank in the amounts of \$35.0 million and \$18.3 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. For trailing twelve month periods until June 2010, up to \$15.0 million of our capital expenditures are treated as being funded from the proceeds of our initial public offering. 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 six months ended June 30, 2010.

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 January 2010, we completed the acquisition of Photonics Innovations, Inc., a maker of active and passive laser materials and tunable lasers for scientific, biomedical, technological, and eye-safe range-finding applications. The acquisition of Photonics Innovations, Inc. was not material to our liquidity or financial position.

In April 2010, we completed the acquisition of Cosytronic, KG, a developer and manufacturer of automated welding turnkey solutions. The acquisition of Cosytronic, KG was not material to our liquidity or financial position.

*Operating activities.* Net cash provided by operating activities decreased by \$0.4 million to \$23.4 million for the six months ended June 30, 2010 from \$23.8 million for the six months ended June 30, 2009, primarily resulting from:

An increase in accounts receivable of \$12.7 million in the six months ended June 30, 2010 compared to a decrease of \$8.2 million in the six months ended June 30, 2009;

A increase in inventory of \$9.5 million in the six months ended June 30, 2010 compared to a decrease in inventory of \$1.7 million in the six months ended June 30, 2009; mostly offset by

An increase in cash provided by higher levels of net income after adding back non-cash charges of \$13.5 million in the six months ended June 30, 2010 as compared to the same period in 2009;

An increase in accrued expenses and other liabilities of \$13.2 million in the six months ended June 30, 2010 compared to a decrease of \$0.4 million in the six months ended June 30, 2009;

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 product, the rate at which we turn inventory has historically been 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 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 \$12.7 million and \$7.8 million in the six months ended June 30, 2010 and 2009, respectively. The cash used in investing activities in 2010 related to the purchase of a new building in Korea to house a new and expanding laser application center, the acquisitions of Photonics Innovations Inc. and Cosytronic, KG and purchases of equipment primarily in the United States and Germany. In 2009 cash used in investing activities was related to capital expenditures on property, plant and equipment in the United States, Germany and Russia for facilities and equipment for diode wafer growth, burn-in test stations and packaging as well as new fiber and component production facilities.

We expect to incur approximately \$25 million in capital expenditures, including acquisitions, in 2010. 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 \$1.1 million in the six months ended June 30, 2010 as compared to net cash provided by financing activities of \$11.1 million in the six months ended June 30, 2009. The cash provided by financing activities in 2010 was primarily related to cash provided by the exercise of stock options. The cash provided by financing activities in 2009 was primarily related to the use of our credit lines.

### **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 period ended December 31, 2009. 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 October 2009, an update was issued to the accounting guidance related to the separation criteria used to determine the unit of accounting for multiple element arrangements. This update removes the objective-and-reliable-evidence-of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, replaces references to *fair value* with *selling price* to distinguish from the fair value measurements required under the *Fair Value Measurements and Disclosures* guidance, provides a hierarchy that entities must use to estimate the selling price, eliminates the use of the residual method for allocation and expands the ongoing disclosure requirements. This guidance is effective for us beginning January 1, 2011, although early adoption is permitted, and adoption can be applied prospectively or retrospectively. We are evaluating the effect that implementation of this update will have, if any, on our consolidated financial position and results of operations upon adoption.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**



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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 funds. 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.

Our exposure to market risk also relates to the increase or decrease in the amount of interest expense we must pay on our bank debt and borrowings on our bank credit facilities. The interest rate on our existing bank debt is currently fixed except for our U.S. revolving line of credit and our Euro credit facility. The rates on our Euro overdraft facilities in Germany and Italy and our Japanese Yen overdraft facility are fixed for twelve-month periods. Approximately 74% of our outstanding debt had a fixed rate of interest as of June 30, 2010. 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 and the Russian Ruble. 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 a \$2.3 million and \$0.5 million for the three months ended June 30, 2010 and 2009, respectively. Management believes that the use of foreign currency financial instruments reduces the risks of certain foreign currency transactions, however, these instruments provide only limited protection. We will continue to analyze our exposure to currency exchange rate fluctuations and may engage in additional 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 first quarter of 2010 with respect to those proceedings previously reported in our Annual Report on Form 10-K for the year ended December 31, 2009, and the Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, except as follows: CardioFocus Inc. and the Company settled by mutual agreement all claims and counterclaims related to the lawsuit asserted by CardioFocus Inc. against the Company.

### **ITEM 1A. RISK FACTORS**

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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, 2009, 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.

***We are subject to litigation alleging that we are infringing third-party intellectual property rights. Intellectual property claims could result in costly litigation and harm our business.***

In recent years, there has been significant litigation involving intellectual property rights in many technology-based industries, including our own. We face risks and uncertainties in connection with such litigation, including the risk that patents issued to others may harm our ability to do business; that there could be existing patents of which we are unaware that could be pertinent to our business; and that it is not possible for us to know whether there are patent applications pending that our products might infringe upon, since patent applications often are not disclosed until a patent is issued or published. Moreover, the frequency with which new patents are granted and the diversity of jurisdictions in which they are granted make it impractical and expensive for us to monitor all patents that may be relevant to our business.

From time to time, we have been notified of allegations and claims that we may be infringing patents or intellectual property rights owned by third parties. In 2007, we settled two patent infringement lawsuits filed against us, and in 2010, we settled another patent infringement lawsuit filed against us. We are presently defending one patent infringement lawsuit.

In November 2006, IMRA America, Inc. filed an action against us alleging that certain products we produce, including but not limited to our continuous wave and pulsed fiber lasers and fiber amplifiers, which account for a significant portion of our revenues, infringe one U.S. patent allegedly owned by IMRA America. IMRA America alleges willful infringement and seeks damages of at least \$10 million, treble damages and injunctive relief. IMRA America also alleges inducement of infringement and contributory infringement. We filed an answer in which we denied infringement and raised additional defenses that the patent is invalid and unenforceable. In addition, we filed declaratory judgment counterclaims based on these three defenses. This lawsuit concerns products made, used, sold or offered for sale in or imported into the United States and therefore the lawsuit affects products that account for a substantial portion of our revenues. This lawsuit does not affect revenues that are derived from products that are not made, used, sold or offered for sale in or imported into the United States. In June 2008, the U.S. Patent and Trademark Office ( USPTO ) ordered re-examination of the patent claims asserted by IMRA America against the Company based on several prior art references that we submitted in an ex parte re-examination request. In July 2009, the USPTO confirmed the patentability of all of the claims in the IMRA America patent over the prior art cited in the re-examination, as well as of new claims added during the re-examination. In August 2009, IPG submitted an additional re-examination request, which was denied by the USPTO. The USPTO issued a re-examination certificate in October 2009. As a result, the U.S. District Court for the Eastern District of Michigan lifted the stay on the litigation. A trial is planned for 2010. IMRA America has informed us that it has patents and applications in foreign jurisdictions directed to similar subject matter as the patent subject to this lawsuit, but has not asserted them against us. The Company has filed oppositions to two IMRA patents in Japan and Germany, which are currently pending.

There can be no assurance that we will be able to dispose without a material effect the litigation with IMRA America, claims or other allegations made against us and claims that may be asserted in the future. The outcome of any litigation, including the pending litigation, is uncertain. Even if we ultimately are successful on the merits of any such litigation, legal and administrative proceedings related to intellectual property are typically expensive and time-consuming, generate negative publicity and divert financial and managerial resources. Some litigants may have greater financial resources than we have and may be able to sustain the costs of complex intellectual property litigation more easily than we can.

If we do not prevail in any intellectual property litigation brought against us, including the lawsuits brought by IMRA America, it could affect our ability to sell our products and materially harm our business, financial condition and results of operations. These developments could adversely affect our ability to compete for customers and

increase our revenues. Plaintiffs in intellectual property cases often seek, and sometimes obtain, injunctive relief. Intellectual property litigation commenced

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against us, including the lawsuits brought by IMRA America that we are presently defending, could force us to take actions that could be harmful to our business, competitive position, results of operations and financial condition, including the following:

stop selling our products or using the technology that contains the allegedly infringing intellectual property;

pay actual monetary damages, royalties, lost profits or increased damages and the plaintiff's attorneys' fees, which individually or in the aggregate may be substantial;

attempt to obtain a license to use the relevant intellectual property, which may not be available on reasonable terms or at all; and

attempt to redesign the products that allegedly infringed upon intellectual property of others, which may be costly or impractical.

In addition, intellectual property lawsuits can be brought by third parties against OEMs and end users that incorporate our products into their systems or processes. In some cases, we indemnify OEMs against third-party infringement claims relating to our products and we often make representations affirming, among other things, that our products do not infringe on the intellectual property rights of others. As a result, we may incur liabilities in connection with lawsuits against our customers. Any such lawsuits, whether or not they have merit, could be time-consuming to defend, damage our reputation or result in substantial and unanticipated costs.

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

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. [Removed and Reserved]**

### **ITEM 5. OTHER INFORMATION**

None.

### **ITEM 6. EXHIBITS**

(a) Exhibits

#### **Exhibit**

<b>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



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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 9, 2010

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

Date: August 9, 2010

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

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