IPG PHOTONICS CORP
Form 10-Q
May 10, 2013
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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 March 31, 2013

OR

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

Commission File Number 001-33155

IPG PHOTONICS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**04-3444218**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**
50 Old Webster Road,	
Oxford, Massachusetts	**01540**
(Address of principal executive offices)	**(Zip code)**

(508) 373-1100

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x 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 x 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	x	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 x

As of May 8, 2013, there were 51,453,749 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

	March 31, 2013	December 31, 2012
	(In thousands, except share and per share data)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 355,715	$ 384,053
Accounts receivable, net	102,793	96,630
Inventories	142,096	139,618
Prepaid income taxes and income taxes receivable	14,397	13,071
Prepaid expenses and other current assets	23,265	18,639
Deferred income taxes, net	11,105	12,948
Total current assets	649,371	664,959
DEFERRED INCOME TAXES, NET	2,344	2,107
GOODWILL	3,258	2,898
INTANGIBLE ASSETS, NET	11,412	7,510
PROPERTY, PLANT AND EQUIPMENT, NET	218,995	210,563
OTHER ASSETS	6,878	7,461
TOTAL	$ 892,258	$ 895,498
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Revolving line-of-credit facilities	$ 9,802	$ 2,442
Current portion of long-term debt	1,529	1,505
Accounts payable	14,575	17,783
Accrued expenses and other liabilities	50,138	51,451
Deferred income taxes, net	2,875	9,831
Income taxes payable	9,191	42,443
Total current liabilities	88,110	125,455
DEFERRED INCOME TAXES AND OTHER LONG-TERM LIABILITIES	18,398	13,102
LONG-TERM DEBT, NET OF CURRENT PORTION	12,525	14,014
Total liabilities	119,033	152,571
COMMITMENTS AND CONTINGENCIES (NOTE 12)		
IPG PHOTONICS CORPORATION STOCKHOLDERS EQUITY:		
Common stock, $0.0001 par value, 175,000,000 shares authorized; 51,432,894 shares issued and outstanding at March 31, 2013; 51,359,247 shares issued and outstanding at December 31, 2012	5	5
Additional paid-in capital	515,755	511,039
Retained earnings	270,104	234,977
Accumulated other comprehensive loss	(12,639)	(3,094)
Total IPG Photonics Corporation stockholders equity	773,225	742,927

TOTAL	$ 892,258	$ 895,498

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended March 31, 2013	2012
	(in thousands, except per share data)	
NET SALES	$ 141,852	$ 123,192
COST OF SALES	66,211	54,508
GROSS PROFIT	75,641	68,684
OPERATING EXPENSES:		
Sales and marketing	5,868	5,132
Research and development	8,798	7,140
General and administrative	11,810	9,949
(Gain) loss on foreign exchange	(481)	1,286
Total operating expenses	25,995	23,507
OPERATING INCOME	49,646	45,177
OTHER INCOME (EXPENSE), Net:		
Interest expense, net	(53)	(129)
Other income (expense), net	70	(1,094)
Total other income (expense)	17	(1,223)
INCOME BEFORE PROVISION FOR INCOME TAXES	49,663	43,954
PROVISION FOR INCOME TAXES	(14,536)	(13,406)
NET INCOME	35,127	30,548
LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS		633
NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION	$ 35,127	$ 29,915
NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION PER SHARE:		
Basic	$ 0.68	$ 0.63
Diluted	$ 0.67	$ 0.61
WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic	51,407	48,446
Diluted	52,350	49,582

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended March 31,	
	2013	**2012**
Net income	$ 35,127	$ 30,548
Other comprehensive income, net of tax:		
Translation adjustments	(9,628)	15,043
Unrealized gain on derivatives	83	57
Total other comprehensive (loss) income	(9,545)	15,100
Comprehensive income	25,582	45,648
Comprehensive loss attributable to noncontrolling interest & redeemable noncontrolling interest		(2,765)
Comprehensive income attributable to IPG Photonics Corporation	$ 25,582	$ 42,883

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 35,127	$ 30,548
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	7,217	6,215
Deferred income taxes	4,324	2,854
Stock-based compensation	2,532	1,998
(Gains) losses on foreign currency transactions	(481)	1,747
Other	(16)	12
Provisions for inventory, warranty & bad debt	3,705	3,799
Changes in assets and liabilities that (used) provided cash:		
Accounts receivable	(8,250)	(12,203)
Inventories	(6,984)	(4,027)
Prepaid expenses and other current assets	(2,212)	(2,395)
Accounts payable	(1,936)	702
Accrued expenses and other liabilities	(2,658)	(6,383)
Income and other taxes payable	(40,243)	5,186
Tax benefit from exercise of employee stock options	(1,464)	(1,048)
Net cash (used in) provided by operating activities	(11,339)	27,005
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(17,746)	(13,779)
Proceeds from sales of property, plant and equipment	89	
Proceeds from short-term investments		7,001
Acquisition of businesses	(5,555)	
Other	375	149
Net cash used in investing activities	(22,837)	(6,629)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from line-of-credit facilities	8,897	5,027
Payments on line-of-credit facilities	(1,415)	(2,333)
Purchase of noncontrolling interests		(700)
Principal payments on long-term borrowings	(1,640)	(360)
Exercise of employee stock options and issuances under employee stock purchase plan	720	749
Tax benefit from exercise of employee stock options	1,464	1,048
Proceeds from follow-on public offering, net of offering expenses		168,268
Net cash provided by financing activities	8,026	171,699
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(2,188)	4,762
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(28,338)	196,837
CASH AND CASH EQUIVALENTS Beginning of period	384,053	180,234
CASH AND CASH EQUIVALENTS End of period	$ 355,715	$ 377,071

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 88	$ 251
Cash paid for income taxes	$ 47,813	$ 6,755
Non-cash transactions:		
Demonstration units transferred from inventory to other assets	$ 625	$ 526
Additions to property, plant and equipment included in accounts payable	$ 1,115	$ 1,847

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION

CONSOLIDATED STATEMENTS OF EQUITY

	Three Months Ended March 31, 2013		2012	
	(In thousands, except share and per share data)			
	Shares	Amount	Shares	Amount
COMMON STOCK				
Balance, beginning of year	51,359,247	$ 5	47,616,115	$ 5
Exercise of stock options	73,647		101,337	
Common stock issued in a public offering			3,250,000	
Balance, end of period	51,432,894	5	50,967,452	5
ADDITIONAL PAID-IN CAPITAL				
Balance, beginning of year		511,039		332,584
Stock-based compensation		2,532		1,998
Exercise of stock options and related tax benefit from exercise		2,184		1,797
Common stock issued in follow-on public offering				168,268
Premium on purchase of noncontrolling interests NCI				(404)
Balance, end of period		515,755		504,243
RETAINED EARNINGS				
Balance, beginning of year		234,977		122,833
Net income attributable to IPG Photonics Corporation		35,127		29,915
Adjustments to redemption value of redeemable NCI				493
Balance, end of period		270,104		153,241
ACCUMULATED OTHER COMPREHENSIVE (LOSS) GAIN				
Balance, beginning of year		(3,094)		(12,100)
Translation adjustments		(9,628)		15,043
Unrealized gain on derivatives, net of tax		83		57
Attribution to NCI & redeemable NCI				(2,123)
Balance, end of period		(12,639)		877
TOTAL IPG PHOTONICS CORPORATION STOCKHOLDERS EQUITY		773,225		658,366
NONCONTROLLING INTERESTS				
Balance, beginning of year				287
Sale of NCI				(700)
Other comprehensive income attributable to NCI				9
Premium on purchase of NCI				404
Balance, end of period				
TOTAL STOCKHOLDERS EQUITY		$ 773,225		$ 658,366

See notes to consolidated financial statements.

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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, 2012.

In the opinion of the Company s management, the unaudited financial information for the interim periods presented reflects all adjustments necessary for a fair presentation of the Company s financial position, results of operations and cash flows. The results reported in these consolidated financial statements are not necessarily indicative of results that may be expected for the entire year.

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

2. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Company s financial statements upon adoption.

3. INVENTORIES

Inventories consist of the following:

	March 31, 2013	December 31, 2012
Components and raw materials	$ 53,603	$ 53,436
Work-in-process	50,394	46,240
Finished goods	38,099	39,942
Total	$ 142,096	$ 139,618

The Company recorded inventory provisions totaling $1,529 and $1,850 for the three months ended March 31, 2013 and 2012, respectively. These provisions relate to the recoverability of the value of inventories due to technological changes and excess quantities. These provisions are reported as a reduction to components and raw materials and finished goods.

4. ACCRUED EXPENSES AND OTHER LIABLILITES

Accrued expenses and other liabilities consist of the following:

	March 31, 2013	December 31, 2012
Accrued compensation	$ 17,746	$ 21,972
Customer deposits and deferred revenue	18,608	17,174

Current portion of accrued warranty	8,040	7,838
Other	5,744	4,467
Total	$ 50,138	$ 51,451

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

5. FINANCING ARRANGEMENTS

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

	March 31, 2013	December 31, 2012
Revolving line-of-credit facilities:		
European Overdraft facilities	$ 1,021	$ 1,135
Euro Line of Credit	751	956
U.S. Line of Credit	8,030	351
Total	$ 9,802	$ 2,442
Term Debt:		
U.S. long-term note	$ 13,667	$ 14,000
Other notes payable	387	1,519
Less: current portion	(1,529)	(1,505)
Total long-term debt	$ 12,525	$ 14,014

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

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 March 31,	
	2013	2012
Net income attributable to IPG Photonics Corporation	$ 35,127	$ 29,915
Adjustments to redemption value of redeemable noncontrolling interests		493
Net income attributable to common stockholders	35,127	30,408
Weighted average shares	51,407	48,446
Dilutive effect of common stock equivalents	943	1,136
Diluted weighted average common shares	52,350	49,582
Basic net income attributable to IPG Photonics Corporation per share	$ 0.68	$ 0.62
Adjustments to redemption value of redeemable noncontrolling interests		0.01

Basic net income attributable to common stockholders	$	0.68	$	0.63
Diluted net income attributable to IPG Photonics Corporation per share	$	0.67	$	0.60
Adjustments to redemption value of redeemable noncontrolling interests				0.01
Diluted net income attributable to common stockholders	$	0.67	$	0.61

The computation of diluted weighted average common shares excludes options to purchase 238,000 and 363,000 shares for the three months ended March 31, 2013 and 2012, respectively, because the effect would be anti-dilutive.

The Company computes net income per share in accordance with ASC 260-*Earnings Per Share*. Under the provisions of ASC 260, the Company is required to present basic and diluted earnings per share information separately for each class of equity instruments that participate in any income distribution with primary equity instruments. The Company calculates earnings per share in periods where a class of common stock was redeemable for other than fair value through the application

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

of the two-class method. Until June 29, 2012, the Company had redeemable noncontrolling interests reported in the accompanying consolidated financial statements related to a 22.5% minority interest of the Company s Russian subsidiary, NTO IRE-Polus.

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 sheet were:

	Notional Amounts[1]		Other Assets		Other Long-Term Liabilities	
	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012	March 31, 2013	December 31, 2012
Interest rate swap	$ 13,667	$ 14,000	$	$	$ 723	$ 855
Total	$ 13,667	$ 14,000	$	$	$ 723	$ 855

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

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 March 31, 2013	Three Months Ended March 31, 2012
Effective portion recognized in other comprehensive (loss) gain, pretax:		
Interest rate swap	$ 267	$ 241
Effective portion reclassified from other comprehensive (loss) gain to interest expense, pretax:		
Interest rate swap	$ (135)	$ (150)
Ineffective portion recognized in income:		
Interest rate swap	$	$

8. FAIR VALUE MEASUREMENTS

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

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

The carrying amounts of cash equivalents, accounts receivable, accounts payable and drawings on revolving lines of credit are considered reasonable estimates of their fair market value, due to the short maturity of these instruments or as a result

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

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.

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

		Fair Value Measurements at March 31, 2013		
	Total	Level 1	Level 2	Level 3
Assets				
Money market funds	$ 58,004	$ 58,004	$	$
Treasury bills	154,007	154,007		
Time deposits	19,223	19,223		
Auction rate securities	1,114			1,114
Total assets	$ 232,348	$ 231,234	$	$ 1,114
Liabilities				
Contingent purchase consideration	$ 3,016	$	$	$ 3,016
Interest rate swaps	723		723	
Total liabilities	$ 3,739	$	$ 723	$ 3,016

		Fair Value Measurements at December 31, 2012		
	Total	Level 1	Level 2	Level 3
Assets				
Money market funds	$ 58,219	$ 58,219	$	$
Treasury bills	159,007	159,007		
Time deposits	19,823	19,823		
Auction rate securities	1,112			1,112
Total assets	$ 238,161	$ 237,049	$	$ 1,112
Liabilities				
Contingent purchase consideration	$ 3,023	$	$	$ 3,023
Interest rate swaps	855		855	
Total liabilities	$ 3,878	$	$ 855	$ 3,023

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 first quarter of 2012, the Company determined a final payment of contingent consideration and other related matters in association with the purchase of a technology company, increased the liability by $987 and reclassed the revised obligation to accrued expenses. As the payment was then fixed, it was no longer measured at its fair value.

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Auction Rate Securities		
Balance, beginning of period	$ 1,112	$ 1,104
Period transactions		
Change in fair value	2	2
Redeemed by issuers at par		
Balance, end of period	$ 1,114	$ 1,106
Contingent Purchase Consideration		
Balance, beginning of period	$ 3,023	$ 999
Period transactions		
Adjustment for determination of final payment		987
Change in fair value	(7)	28
Reclass of determined final payment		(1,417)
Balance, end of period	$ 3,016	$ 597
Warrant		
Balance, beginning of period	$	$ 77
Period transactions		
Change in fair value		
Balance, end of period	$	$ 77

9. GOODWILL AND INTANGIBLES

The following table sets forth the changes in the carrying amount of goodwill for the three months ended March 31, 2013:

	Amounts
Balance at January 1	$ 2,898
Adjustment	(95)
Total Goodwill arising from the acquisition	455
Balance at March 31	$ 3,258

Intangible assets consisted of the following:

(In thousands)	March 31, 2013 Gross Carrying	March 31, 2013 Accumulated Amortization	March 31, 2013 Net Carrying Amount	March 31, 2013 Weighted-Average	December 31, 2012 Gross Carrying	December 31, 2012 Accumulated Amortization	December 31, 2012 Net Carrying	December 31, 2012 Weighted-

	Amount			Lives	Amount		Amount	Average Lives
Amortizable intangible assets								
Patents	$ 4,664	$ (4,218)	$ 446	6 Years	$ 4,664	$ (4,193)	$ 471	6 Years
Customer relationships	3,899	(2,481)	1,418	5 Years	3,993	(2,363)	1,630	5 Years
Production know-how	6,938	(763)	6,175	8 Years	2,514	(656)	1,858	9 Years
Technology, trademark and tradename	4,193	(820)	3,373	8 Years	4,229	(678)	3,551	8 Years
	$ 19,694	$ (8,282)	$ 11,412		$ 15,400	$ (7,890)	$ 7,510	

On March 13, 2013, the Company acquired the working capital and long term assets of Mobius Photonics Inc. (Mobius) which is a manufacturer of high-power pulsed ultra-violet (UV) fiber lasers for micro-machining and fine processing applications. As a result of the acquisition, the Company recorded intangible assets of $4,480 of which all related to related to technology and know-how. Additionally, the Company recorded $455 of goodwill related to expected synergies for the Company s expansion of product offerings with UV and short pulsed fiber lasers.

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IPG PHOTONICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

The purchase price allocation included in the Company s financial statements are not complete and represent the preliminary fair value estimates as of March 31, 2013 and are subject to subsequent adjustment as the Company obtains additional information during the measurement period and finalizes its fair value estimates. Any subsequent adjustments to these fair value estimates occurring during the measurement period will result in an adjustment to goodwill or income, as applicable.

Amortization expense for the three months ended March 31, 2013 and 2012 was $463 and $551, respectively. The estimated future amortization expense for intangibles for the remainder of 2013 and subsequent years is as follows:

2013	2014	2015	2016	2017	Thereafter	Total
$1,744	$ 2,188	$ 1,648	$ 1,441	$ 1,415	$ 2,976	$ 11,412

10. PRODUCT WARRANTIES

The Company typically provides one to three-year parts and service warranties on lasers and amplifiers. Most of the Company s sales offices provide support to customers in their respective geographic areas. Warranty reserves have generally been sufficient to cover product warranty repair and replacement costs. The following table summarizes product warranty activity recorded during the three months ended March 31, 2013 and 2012.

	2013	2012
Balance at January 1	$ 10,714	$ 8,631
Provision for warranty accrual	2,035	1,420
Warranty claims and other reductions	(1,435)	(1,082)
Foreign currency translation	(260)	267
Balance at March 31	$ 11,054	$ 9,236

Accrued warranty reported in the accompanying consolidated financial statements as of March 31, 2013 and December 31, 2012 consist of $8,040 and $7,838 in accrued expenses and other liabilities and $3,014 and $2,876 in other long-term liabilities, respectively.

11. INCOME TAXES

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

	2013	2012
Balance at January 1	$ 5,392	$ 4,509
Reductions of prior period positions	(63)	
Additions for tax positions in prior period		
Additions for tax positions in current period	255	
Balance at March 31	$ 5,584	$ 4,509

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

12. COMMITMENTS AND CONTINGENCIES

From time to time, the Company may be involved in disputes and legal proceedings in the ordinary course of its business. These proceedings may include allegations of infringement of intellectual property, commercial disputes and employment matters. As of March 31, 2013 and through the filing date of these Financial Statements, the Company has no legal proceedings ongoing that management estimates could have a material effect on the Company s Consolidated Financial Statements.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
You should read the following discussion in conjunction with our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward looking statements that are based on management s current expectations, estimates and projections about our business and operations. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements. See Cautionary Statement Regarding Forward-Looking Statements.

Overview

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

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

Factors and Trends That Affect Our Operations and Financial Results

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

Net sales. We derive net sales primarily from the sale of fiber lasers and amplifiers. We also sell diode lasers, communications systems, laser systems and complementary products. We sell our products through our direct sales organization and our network of distributors and sales representatives, as well as system integrators. We sell our products to OEMs that supply materials processing laser systems, communications systems and medical laser systems to end users. We also sell our products to end users that build their own systems which incorporate our products or use our products as an energy or light source. Our scientists and engineers work closely with OEMs, systems integrators and end users to analyze their system requirements and match appropriate fiber laser or amplifier specifications. Our sales cycle varies substantially, ranging from a period of a few weeks to as long as one year or more, but is typically several months.

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

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

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

Gross margin. Our total gross margin in any period can be significantly affected by total net sales in any period, by product mix, that is, the percentage of our revenue in the period that is attributable to higher or lower-power products, and 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. Also, the profit margins on systems can be lower than margins for our laser and amplifier sources, depending on the configuration, volume and competitive forces, among other factors.

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

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reduced. Gross margins generally improve when the opposite occurs. If both sales and inventory decrease in the same period, the decline in gross margin may be greater if we cannot reduce fixed costs or choose not to reduce fixed costs to match the decrease in the level of production. If we experience a decline in sales that reduces absorption of our fixed costs, or if we have production issues or inventory write-downs, our gross margins will be negatively affected.

We also regularly review our inventory for items that are slow-moving, have been rendered obsolete or determined to be excess. Any write-off of such slow-moving, obsolete or excess inventory affects our gross margins. For example, we recorded provisions for inventory totaling $1.5 million and $1.9 million for the three months ended March 31, 2013 and 2012, respectively and $8.2 million, $6.1 million and $2.7 million for the years ended December 31, 2012, 2011 and 2010, 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 and transaction activities.

Major customers. While we have historically depended on a few customers for a large percentage of our annual net sales, the composition of this group can change from year to year. Net sales derived from our five largest customers as a percentage of our net sales were 22% for the three months ended March 31, 2013 and 16%, 17% and 19% for the full years 2012, 2011 and 2010, 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 March 31, 2013 compared to the three months ended March 31, 2012

Net sales. Net sales increased by $18.7 million, or 15.1%, to $141.9 million for the three months ended March 31, 2013 from $123.2 million for the three months ended March 31, 2012.

	Three Months Ended March 31,				
	2013		2012		Change
		% of Total		% of Total	
Materials processing	$ 133,045	93.8%			