IPG PHOTONICS CORP
Form 10-Q
November 05, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018
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 incorporation or organization)	**(I.R.S. Employer Identification Number)**
50 Old Webster Road, Oxford, Massachusetts	**01540**
	(Zip code)

(Address of principal executive offices)

(508) 373-1100
(Registrant's telephone number, including area code)

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

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

Large Accelerated Filer	ý	Accelerated Filer	¨
Non-Accelerated Filer	¨	Smaller Reporting Company	¨
Emerging Growth Company	¨		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO ý

As of November 1, 2018, there were 54,364,246 and 53,400,171 shares of the registrant's common stock issued and outstanding.

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EX-101.CAL XBRL TAXONOMY EXTENSION CALCULATION LINKBASE

EX-101.LAB XBRL TAXONOMY EXTENSION LABEL LINKBASE

EX-101.PRE XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE

EX-101.DEF XBRL TAXONOMY EXTENSION DEFINITION LINKBASE

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PART I-FINANCIAL INFORMATION

ITEM 1. UNAUDITED INTERIM FINANCIAL STATEMENTS

IPG PHOTONICS CORPORATION

CONSOLIDATED BALANCE SHEETS

	September 30, 2018	December 31, 2017
	(In thousands, except share and per share data)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 647,606	$ 909,900
Short-term investments	474,422	206,257
Accounts receivable, net	251,613	237,278
Inventories	397,409	307,712
Prepaid income taxes	61,222	44,944
Prepaid expenses and other current assets	50,013	47,919
Total current assets	1,882,285	1,754,010
DEFERRED INCOME TAXES, NET	19,995	26,976
GOODWILL	56,769	55,831
INTANGIBLE ASSETS, NET	45,844	51,223
PROPERTY, PLANT AND EQUIPMENT, NET	529,163	460,206
	28,043	19,009

OTHER ASSETS				
TOTAL ASSETS	$	2,562,099	$	2,367,255
LIABILITIES AND EQUITY				
CURRENT LIABILITIES:				
Current portion of long-term debt	$	3,654	$	3,604
Accounts payable	29,494		35,109	
Accrued expenses and other liabilities	137,060		144,417	
Income taxes payable	47,777		15,773	
Total current liabilities	217,985		198,903	
DEFERRED INCOME TAXES AND OTHER LONG-TERM LIABILITIES	94,675		100,652	
LONG-TERM DEBT, NET OF CURRENT PORTION	42,631		45,378	
Total liabilities	355,291		344,933	
COMMITMENTS AND CONTINGENCIES (NOTE 11)				
IPG PHOTONICS				

CORPORATION EQUITY:		
Common stock, $0.0001 par value, 175,000,000 shares authorized; 54,362,579 and 53,398,504 shares issued and outstanding, respectively, at September 30, 2018; 54,007,708 and 53,629,439 shares issued and outstanding, respectively, at December 31, 2017	5	5
Treasury stock, at cost (964,075 and 378,269 shares held)	(160,779)	(48,933)
Additional paid-in capital	738,285	704,727
Retained earnings	1,772,941	1,443,867
	(144,409)	(77,344)

Accumulated other comprehensive loss				
Total IPG Photonics Corporation equity	2,205,963		2,022,322	
NONCONTROLLING INTERESTS	845		—	
Total equity	2,206,808		2,022,322	
TOTAL LIABILITIES AND EQUITY	$	2,562,099	$	2,367,255

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands, except per share data)			
NET SALES	$ 356,346	$ 392,615	$ 1,129,823	$ 1,047,834
COST OF SALES	161,162	168,060	496,303	459,716
GROSS PROFIT	195,184	224,555	633,520	588,118
OPERATING EXPENSES:				
Sales and marketing	13,479	13,384	41,531	36,347
Research and development	30,909	25,541	91,268	74,281
General and administrative	25,245	21,491	74,857	59,092
Loss (gain) on foreign exchange	1,688	3,917	(1,489)	15,553
Total operating expenses	71,321	64,333	206,167	185,273
OPERATING INCOME	123,863	160,222	427,353	402,845
OTHER INCOME (EXPENSE), Net:				
Interest income, net	3,884	(125)	4,925	651
Other income (expense), net	423	459	1,252	(47)
Total other income	4,307	334	6,177	604
INCOME BEFORE PROVISION FOR INCOME TAXES	128,170	160,556	433,530	403,449
PROVISION FOR INCOME TAXES	(27,418)	(44,959)	(104,827)	(108,817)
NET INCOME	100,752	115,597	328,703	294,632
LESS: NET INCOME (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS	235	—	235	(26)
NET INCOME ATTRIBUTABLE TO IPG PHOTONICS CORPORATION	$ 100,517	$ 115,597	$ 328,468	$ 294,658
NET INCOME ATTRIBUTABLE TO IPG PHOTONICS				

CORPORATION PER SHARE:				
Basic	$ 1.88	$ 2.16	$ 6.12	$ 5.51
Diluted	$ 1.84	$ 2.11	$ 5.97	$ 5.40
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	53,571	53,440	53,677	53,453
Diluted	54,696	54,698	54,995	54,570

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Net income	$ 100,752	$ 115,597	$ 328,703	$ 294,632
Other comprehensive income, net of tax:				
Translation adjustments	(15,047)	29,855	(67,072)	89,076
Unrealized gain (loss) on derivatives	(5)	11	(3)	(35)
Effect of adopted accounting standards	—	—	10	—
Available-for-sale investments, net of tax, reclassified to net income	—	—	—	298
Total other comprehensive (loss) income	(15,052)	29,866	(67,065)	89,339
Comprehensive income	85,700	145,463	261,638	383,971
Comprehensive income (loss) attributable to noncontrolling interests	196	—	196	(26)
Comprehensive income attributable to IPG Photonics Corporation	$ 85,504	$ 145,463	$ 261,442	$ 383,997

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2018	2017
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 328,703	$ 294,632
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	58,894	46,416
Deferred income taxes	2,954	14,534
Stock-based compensation	21,443	16,989
Unrealized (gain) loss on foreign currency transactions	(1,779)	8,197
Other	(1,936)	699
Provisions for inventory, warranty & bad debt	30,582	34,690
Changes in assets and liabilities that (used) provided cash:		
Accounts receivable	(26,058)	(56,416)
Inventories	(122,051)	(39,697)
Prepaid expenses and other current assets	(4,925)	(1,560)
Accounts payable	(1,319)	3,423
Accrued expenses and other liabilities	(20,095)	1,809
Income and other taxes payable	15,838	(26,866)
Net cash provided by operating	280,251	296,850

activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of and deposits on property, plant and equipment	(133,355)	(99,221)
Proceeds from sales of property, plant and equipment	755	15,437
Purchases of investments	(566,498)	(146,585)
Proceeds from sales and maturities of investments	286,346	188,143
Acquisitions of businesses, net of cash acquired	(4,423)	(50,594)
Other	307	(496)
Net cash used in investing activities	(416,868)	(93,316)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from line-of-credit facilities	255	6,761
Payments on line-of-credit facilities	(255)	(6,761)
Purchase of noncontrolling interests	—	(197)
Proceeds on long-term borrowings	—	28,000
Principal payments on long-term borrowings	(2,696)	(18,951)
Proceeds from issuance of common stock under employee stock option and purchase plans less payments	12,115	23,296

for taxes related to net share settlement of equity awards				
Cash contributed by noncontrolling interests	378		—	
Purchase of treasury stock, at cost	(111,926)		(26,911)	
Net cash (used in) provided by financing activities	(102,129)		5,237	
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	(23,548)		47,641	
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(262,294)		256,412	
CASH AND CASH EQUIVALENTS — Beginning of period	909,900		623,855	
CASH AND CASH EQUIVALENTS — End of period	$	647,606	$	880,267
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid for interest	$	2,402	$	1,965
Cash paid for income taxes	$	94,801	$	118,660
Non-cash transactions:				
Demonstration units transferred from inventory to other assets	$	3,787	$	3,290
Inventory transferred to machinery and equipment	$	2,114	$	4,087
Changes in accounts payable related to	$	(3,337)	$	(15)

property, plant and
equipment

See notes to consolidated financial statements.

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IPG PHOTONICS CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY

	Nine Months Ended September 30,			
	2018		2017	
	(In thousands, except share and per share data)			
	Shares	Amount	Shares	Amount
COMMON STOCK				
Balance, beginning of year	53,629,439	$ 5	53,251,805	$ 5
Exercise of stock options and conversion of restricted stock units	342,673	—	543,547	—
Common stock issued under employee stock purchase plan	12,198	—	19,882	—
Purchased common stock	(585,806)	—	(215,860)	—
Balance, end of period	53,398,504		53,599,374	5
TREASURY STOCK				
Balance, beginning of year	(378,248)	(48,933)	(102,774)	(8,946)
Purchased treasury stock	(585,806)	(101,926)	(215,860)	(26,911)
Balance, end of period	(964,054)	(150,859)	(318,634)	(35,857)
ADDITIONAL PAID-IN CAPITAL				
Balance, beginning of year		704,727		650,974
Stock-based compensation		21,443		16,989
Common stock issued under employee stock option plan, net of shares withheld for employee taxes		9,827		21,627
Proceeds from issuance of common stock issued under employee stock purchase plan		2,288		1,669
Effect of adopted accounting standards		—		2,078
Balance, end of period		738,285		693,337

RETAINED EARNINGS		
Balance, beginning of year	1,443,867	1,094,108
Net income attributable to IPG Photonics Corporation	328,468	294,658
Effect of adopted accounting standards	606	2,145
Balance, end of period	1,772,941	1,390,911
ACCUMULATED OTHER COMPREHENSIVE LOSS		
Balance, beginning of year	(77,344)	(178,583)
Translation adjustments	(67,072)	89,023
Unrealized loss on derivatives, net of tax	(3)	(35)
Unrealized loss on available-for-sale investments, net of tax	—	(240)
Realized loss on available-for-sale investments, net of tax, reclassified to net income	—	538
Effect of adopted accounting standards	10	—
Balance, end of period	(144,409)	(89,297)
TOTAL IPG PHOTONICS CORPORATION EQUITY	2,205,963	1,959,099
NONCONTROLLING INTERESTS ("NCI")		
Balance, beginning of year	—	166
Noncontrolling interest of acquired company	649	(197)
Net income (loss) attributable to NCI	235	(26)
Translation adjustments	(39)	57
Balance, end of period	845	—
TOTAL EQUITY	$ 2,206,808	$ 1,959,099

See notes to consolidated financial statements.

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PHOTONICS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — The accompanying unaudited consolidated financial statements have been prepared by IPG Photonics Corporation, or "IPG", "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, 2017.

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.

In accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 606, "Revenue from Contracts with Customers," ("ASC 606" or the "new revenue standard"), the following significant accounting policies have been adopted as of January 1, 2018.

Revenue Recognition — Revenue is recognized when transfer of control to the customer occurs in an amount reflecting the consideration that the Company expects to be entitled. In order to achieve this core principle, the Company applies the following five step approach: (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when a performance obligation is satisfied.

The Company considers customer purchase orders, which in some cases are governed by master sales agreements, to be the contracts with a customer. As part of its consideration of the contract, the Company evaluates certain factors including the customer's ability to pay (or credit risk). For each contract, the Company considers the promise to transfer products, each of which is distinct as the identified performance obligations. In determining the transaction price, the Company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the Company expects to be entitled. As the Company's standard payment terms are less than one year, the Company has elected the practical expedient under ASC 606-10-32-18 to not assess whether a contract has a significant financing component. The Company allocates the transaction price to each distinct product based on its relative standalone selling price. Revenue is recognized when control of the product is transferred to the customer (i.e., when the Company's performance obligation is satisfied), which typically occurs at shipment.

The Company often receives orders with multiple delivery dates that may extend across several reporting periods. The Company allocates the transaction price of the contract to each delivery based on the product standalone selling price. The Company invoices for each scheduled delivery upon shipment and recognizes revenues for such delivery at that point, assuming transfer of control has occurred. As scheduled delivery dates are generally within 1 year, under the optional exemption provided by ASC 606-10-50-14 revenues allocated to future shipments of partially completed contracts are not disclosed.

Rights of return generally are not included in customer contracts. Accordingly, upon application of steps one through five above, product revenue is recognized upon shipment and transfer of control. Returns are infrequent and are recorded as a reduction of revenue.

In certain subsidiaries the Company provides sales commissions to sales representatives based on sales volume. The Company has determined that the incentive portion of its sales commissions qualify as contract costs. The Company has elected the practical expedient in ASC 340-40-25-4 to expense sales commissions when incurred as the amortization period of the asset that would otherwise have been recognized is one year or less.

Revenue Recognition at a Point in Time —Revenues recognized at a point in time consist primarily of product, installation and service sales. The Company sells products to original equipment manufacturers ("OEMs") that supply materials processing laser systems, communications systems, medical laser systems and other laser systems for advanced applications to end users. The Company also sells products to end users that use IPG products directly to build their own systems, which

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PHOTONICS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(In thousands, except share and per share data)

incorporate IPG products or use IPG products as an energy or light source. The Company recognizes revenue for laser and spare part sales following the transfer of control of such products to the customer, which typically occurs upon shipment or delivery depending on the terms of the underlying contracts. Installation revenue is recognized upon completion of the installation service, which typically occurs within 90 days of delivery. For laser systems that carry customer specific processing requirements, revenue is recognized at the latter of customer acceptance date or shipment date if the customer acceptance is made prior to shipment. When sales contracts contain multiple performance obligations, such as the shipment or delivery of products and installation, the Company allocates the transaction price to each performance obligation identified in the contract based on relative standalone selling prices and recognizes the related revenue as control of each individual product or service is transferred to the customer, in satisfaction of the corresponding performance obligations.

Revenue Recognition over Time — The Company offers extended warranty agreements, which extend the standard warranty periods. Warranties are limited and provide that the product meets specifications and is free from defects in materials and workmanship. Extended warranties are sold separately from products and represent a distinct performance obligation. Revenue related to the performance obligation for extended warranties is recognized over time as the customer simultaneously receives and consumes the benefits provided by the Company. The customer receives the assurance that the product will operate in accordance with agreed-upon specifications evenly during the extended warranty period regardless of whether they make a claim during that period, and therefore, revenue at time of sale is deferred and recognized over the time period of the extended warranty period.

Customer Deposits and Deferred Revenue — When the Company receives consideration from a customer or such consideration is unconditionally due prior to transferring goods or services under the terms of a sales contract, the Company records customer deposits or deferred revenue, which represent contract liabilities. The Company recognizes deferred revenue as net sales after control of the goods or services has been transferred to the customer and all revenue recognition criteria are met.

Reclassifications — Certain prior year amounts have been reclassified to conform with current period presentation. These reclassifications had no effect on the reported results of operations.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Adopted Pronouncements —

On January 1, 2018, the Company adopted ASC 606 and all related amendments using the modified retrospective method for contracts that were not completed as of the date of initial application. The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company expects the impact of the adoption of the new standard to be immaterial to net income on an ongoing basis.

A majority of revenue continues to be recognized at a point in time when control transfers based on the terms of underlying contact. Under the new revenue standard, the Company changed from deferring revenue for installation services in an amount equal to the greater of the cash received related to installation or the fair value to deferring the standalone selling price for these services.

In February 2018, the FASB issued ASU No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"). ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act ("the Act"). The Company adopted this standard during the first quarter of 2018, which resulted in the reclassification of $10 related to the tax effect of unrealized gains on derivatives.

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes (Topic 740) - Intra-Entity Transfers of Assets other than Inventory" ("ASU 2016-16"). ASU 2016-16 eliminates the current exception that prohibits the recognition of current and deferred income tax consequences for intra-entity asset transfers (other than inventory) until the asset has been sold to an outside party. The amendments have been applied on a modified retrospective basis through a cumulative effect adjustment to retained earnings. The Company adopted this standard during the first quarter of 2018, which resulted in the reclassification of prepaid income taxes, deferred income taxes and retained earnings. The cumulative effect of the changes made to the Company's consolidated January 1, 2018 balance sheet for the adoption of ASC 606, ASU 2018-02 and ASU 2016-16 was as follows:

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PHOTONICS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(In thousands, except share and per share data)

	Balance at 12/31/2017	Adoption of ASC 606	Adoption of ASU 2018-02	Adoption of ASU 2016-16	Balance at 1/1/2018
Balance Sheet					
Prepaid income taxes	$ 44,944	$ —	$ —	$ (1,203)	$ 43,741
Deferred income tax assets	26,976	(55)	—	1,229	28,150
Customer deposits and deferred revenue (short-term)	47,324	(816)	—	—	46,508
Income taxes payable	15,773	37	—	—	15,810
Deferred income tax liabilities	21,362	134	—	—	21,496
Retained earnings	1,443,867	590	(10)	26	1,444,473
Accumulated other comprehensive loss	(77,344)	—	10	—	(77,334)

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350)" ("ASU 2017-04"). ASU 2017-04 simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. The amendments are applied prospectively upon adoption. The Company early adopted this standard during the first quarter of 2018. The Company performs its annual goodwill impairment assessment on October 1 of each year. The new impairment test will be used in the annual assessment or if events or changes in circumstances indicate that the carrying amount may not be recoverable and an impairment analysis is performed.

Other Pronouncements Currently Under Evaluation —

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02" or "the new lease standard"). ASU 2016-02 requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than twelve months. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. In July 2018, the FASB issued ASU 2018-11, which provides an additional transition method for implementing the new lease standard. The Company will adopt the provisions of ASU 2018-11 by applying the standard at the adoption date and recognizing a cumulative-effect adjustment. The Company is currently completing its review of the lease population and is in the process of implementing a software solution to assist with lease accounting and evaluating footnote disclosures. The Company does not expect that the standard will have a material effect on its consolidated financial statements upon adoption.

In June 2018, the FASB issued ASU No. 2018-07, "Compensation - Stock Compensation (Topic 718)" ("ASU 2018-07"). ASU 2018-07 aligns the accounting for share-based payments issued to employees and non-employees. ASU 2018-07 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. The Company is currently evaluating the standard but does not expect that it will have a material effect on its consolidated financial statements upon adoption.

3. REVENUE FROM CONTRACTS WITH CUSTOMERS

The following tables represent a disaggregation of revenue from contracts with customers for the three and nine months ended September 30, 2018:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
Sales by Application				
Materials processing	$	334,498	$	1,065,712
Other applications	21,848		64,111	
Total	$	356,346	$	1,129,823

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PHOTONICS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(In thousands, except share and per share data)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
Sales by Product				
High Power Continuous Wave ("CW") Lasers	$	227,462	$	724,111
Medium Power CW Lasers	15,825		65,092	
Low Power CW Lasers	3,276		10,380	
Pulsed Lasers	35,408		115,243	
Quasi-Continuous Wave ("QCW") Lasers	18,276		54,568	
Other Revenue including Amplifiers, Laser Systems, Service, Parts, Accessories and Change in Deferred Revenue	56,099		160,429	
Total	$	356,346	$	1,129,823

Sales by Geography				
United States and other North America	$	53,762	$	140,704
Europe:				
Germany	21,714		86,939	
Other including Eastern Europe/CIS	66,392		225,717	
Asia and Australia:				
China	158,853		511,852	
Japan	21,871		60,927	
Other	31,953		99,476	
Rest of World	1,801		4,208	

Total	$	356,346	$	1,129,823

Timing of Revenue Recognition				
Goods and services transferred at a point in time	$	355,191	$	1,126,285
Services transferred over time	1,155		3,538	
Total	$	356,346	$	1,129,823

The Company enters into contracts to sell lasers and spare parts, for which revenue is generally recognized upon shipment or delivery, depending on the terms of the contract. The Company also provides installation services and extended warranties. The Company frequently receives consideration from a customer prior to transferring goods to the customer under the terms of a sales contract. The Company records customer deposits related to these prepayments, which represent a contract liability. The Company also records deferred revenue related to installation services when consideration is received before the services have been performed. The Company recognizes customer deposits and deferred revenue as net sales after control of the goods or services has been transferred to the customer and all revenue recognition criteria is met. The Company bills customers for extended warranties upon entering into the agreement with the customer, resulting in deferred revenue. Revenue is recognized ratably over the term of the extended warranty agreement as the customer receives and consumes the benefits of such services.

Before the transition date (under ASC 605, *Revenue Recognition*), the Company deferred revenue for installation services in an amount equal to the greater of the cash received or the fair value for installation. Under the new revenue standard, the standalone selling price for installation services is deferred until control has transferred. The standalone selling price for installation services is determined based on the estimated number of days of service technician time required for installation at standard service rates. The impact of applying ASC 606 was a decrease in revenue recognized during the three months ended September 30, 2018 of $37 and a decrease for the nine months ended September 30, 2018 of $84 as compared to revenue accounted for under ASC 605.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
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The following table reflects the changes in the Company's contract liabilities for the nine months ended September 30, 2018:

	September 30, 2018	January 1, 2018	Change	
Contract liabilities				
Customer deposits	$ 36,967	$ 36,937	$ 30	0.1 %
Deferred revenue - current	11,307	9,571	1,736	18.1 %
Deferred revenue - long-term	1,374	182	1,192	654.9 %

During the three and nine months ended September 30, 2018, the Company recognized revenue of $3,355 and $38,885, respectively, that was included in the customer deposits and deferred revenue balances at the beginning of the period.

The following table represents the Company's remaining performance obligations for sales of installation services and extended warranties and contracts with customer acceptance provisions included in deferred revenue as of September 30, 2018:

	Remaining Performance Obligations						
	2018	2019	2020	2021	2022	2023	Total
Revenue expected to be recognized upon customer acceptance	$ 7,443	$ 24	$ 3	$ —	$ —	$ —	$ 7,470
Revenue expected to be recognized on contracts for installation services	246	236	—	—	—	—	482
Revenue expected to be recognized for extended	1,165	1,910	576	349	178	60	4,238

warranty agreements							
Revenue deferred based on volume discount incentives	—	491	—	—	—	—	491
Total	$ 8,854	$ 2,661	$ 579	$ 349	$ 178	$ 60	$ 12,681

4. FAIR VALUE MEASUREMENTS

The Company's financial instruments consist of cash equivalents, short-term and long-term investments, accounts receivable, accounts payable, drawings on revolving lines of credit, long-term debt, contingent purchase consideration, and an interest rate swap.

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 money market fund deposits, term deposits, 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 most of these instruments or as a result of the competitive market interest rates, which have been negotiated. The Company's bond securities are reported at fair value based upon quoted prices for instruments with identical terms in active markets. The Company's commercial paper securities reported at fair value are based upon model-driven valuations in which all significant inputs are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset or liability, and are therefore classified as Level 2.

At September 30, 2018 and December 31, 2017, the Company's long-term debt consisted of a variable rate long-term note and a fixed rate long-term note. The book value of the long-term notes approximates the fair market value.

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

	Fair Value Measurements at September 30, 2018			
	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents:				
Money market fund deposits and term deposits	$ 316,442	$ 316,442	$ —	$ —
U.S. Treasury and agency obligations	8,999	8,999	—	—
Commercial paper	89,312	—	89,312	—
Short-term investments				
U.S. Treasury and agency obligations	113,094	113,094	—	—
Corporate bonds	196,856	196,856	—	—
Commercial paper	164,255	—	164,255	—
Long-term investments and other assets:				
Corporate bonds	13,771	13,771	—	—
Auction rate securities	967	—	—	967
Interest rate swap	13	—	13	—
Total	$ 903,709	$ 649,162	$ 253,580	$ 967
Liabilities				
Long-term debt	$ 46,285	$ —	$ 46,285	$ —
Contingent purchase consideration	902	—	—	902
Total	$ 47,187	$ —	$ 46,285	$ 902

Fair Value Measurements at December 31, 2017

	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents				
Money market fund deposits and term deposits	$ 425,917	$ 425,917	$ —	$ —
Short-term investments				
U.S. Treasury and agency obligations	41,217	41,217	—	—
Corporate bonds	131,048	131,048	—	—
Commercial paper	33,896	33,896	—	—
Long-term investments and other assets:				
Auction rate securities	1,016	—	—	1,016
Interest rate swaps	16	—	16	—
Total	$ 633,110	$ 632,078	$ 16	$ 1,016
Liabilities				
Long-term debt	$ 48,982	$ —	$ 48,982	$ —
Contingent purchase consideration	902	—	—	902
Total	$ 49,884	$ —	$ 48,982	$ 902

The fair value of the short-term investments considered held-to-maturity as of September 30, 2018 and December 31, 2017 was $474,205 and $206,161, respectively, which represents an unrealized loss of $(217) and $(96), respectively, as compared to the book value recorded on the Consolidated Balance Sheets for the same periods. The fair value of the long-term investments considered held-to-maturity as of September 30, 2018 was $14,738, which represented an unrealized gain of $118, as compared to the book value of $14,620 recorded within Other Assets on the Consolidated Balance Sheets for the same period.

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The fair value of the interest rate swap considered pricing models whose inputs are observable for the securities held by the Company.

The fair value of the auction rate securities was determined using prices observed in inactive markets with limited observable data for the securities held by the Company.

The fair value of contingent purchase consideration was determined using an income approach at the respective business combination date and at the reporting date. That approach is based on significant inputs that are not observable in the market and include key assumptions such as assessing the probability of meeting certain milestones required to earn the contingent purchase consideration.

The following table presents information about the Company's movement in Level 3 assets and liabilities measured at fair value:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Auction rate securities				
Balance, beginning of period	$ 1,174	$ 1,148	$ 1,016	$ 1,144
Period transactions	(207)	(138)	(207)	(138)
Change in fair value and accretion	—	2	158	6
Balance, end of period	$ 967	$ 1,012	$ 967	$ 1,012
Contingent purchase consideration				
Balance, beginning of period	$ 902	$ —	$ 902	$ —
Balance, end of period	$ 902	$ —	$ 902	$ —

The following table presents the effective maturity dates of held-to-maturity debt investments as of September 30, 2018 and December 31, 2017:

	September 30, 2018		December 31, 2017	
	Book Value	Fair Value	Book Value	Fair Value
Investment maturity				
Less than 1 year	$ 572,815	$ 572,516	$ 206,161	$ 206,161

1 through 5 years	13,776	13,771	—	—
Greater than 5 years	844	967	1,016	1,016
Total	$ 587,435	$ 587,254	$ 207,177	$ 207,177

5. INVENTORIES
Inventories consist of the following:

	September 30, 2018	December 31, 2017
Components and raw materials	$ 240,635	$ 145,261
Work-in-process	40,763	43,646
Finished components and devices	116,011	118,805
Total	$ 397,409	$ 307,712

The Company recorded inventory provisions totaling $3,076 and $4,033 for the three months ended September 30, 2018 and 2017, respectively, and $9,930 and $13,439 for the nine months ended September 30, 2018 and 2017, 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 components and devices.

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6. GOODWILL AND INTANGIBLES

The following table sets forth the changes in the carrying amount of goodwill for the nine months ended September 30, 2018:

	Amounts	
Balance at January 1	$	55,831
Goodwill arising from acquisition	4,072	
Adjustment to goodwill during measurement period	(2,948)	
Foreign exchange adjustment	(186)	
Balance at September 30	$	56,769

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

	September 30, 2018												December 31, 2017			
	Gross Carrying Amount		Accumulated Amortization		Net Carrying Amount		Weighted-Average Lives	Gross Carrying Amount		Accumulated Amortization		Net Carrying Amount		Weighted-Average Lives		
Patents	$	8,036	$	(5,893)	$	2,143	8 Years	$	8,036	$	(5,486)	$	2,550	8 Years		
Customer relationships	25,577		(5,603)		19,974		11 Years	26,768		(5,584)		21,184		11 Years		
Production know-how	6,768		(5,595)		1,173		8 Years	6,820		(5,035)		1,785		8 Years		
Technology, trademark and trade names	32,358		(9,804)		22,554		7 Years	32,564		(6,860)		25,704		8 Years		
Total	$	72,739	$	(26,895)	$	45,844		$	74,188	$	(22,965)	$	51,223			

During the second quarter of 2018, the Company acquired 100% of the shares of robot concept GmbH ("RC"). RC is located near Munich, Germany, and is an integrator of laser-based systems. The Company paid $4,453 to acquire RC, which represents the fair value on that date. Any excess of the acquisition consideration over the fair value of assets acquired and liabilities assumed is allocated to goodwill, which amounted to $4,072. The goodwill arising from the acquisition will not be deductible for tax purposes. As a result of the acquisition, the Company recorded intangible assets of $104 related to trademark and trade name with a weighted-average useful life of 1 year and $557 related to customer relationships with a weighted-average life of 10 years.

Amortization expense for the three months ended September 30, 2018 and 2017 was $1,982 and $1,725, respectively. Amortization for the nine months ended September 30, 2018 and 2017 was $5,821 and $3,958, respectively. The estimated future amortization expense for intangibles for the remainder of 2018 and subsequent years is as follows:

2018	2019	2020	2021	2022	Thereafter	Total
$ 1,870	$ 7,400	$ 6,747	$ 6,574	$ 5,775	$ 17,478	$ 45,844

7. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities consist of the following:

	September 30, 2018	December 31, 2017
Accrued compensation	$ 57,037	$ 63,203
Customer deposits and deferred revenue	48,274	47,324
Current portion of accrued warranty	22,045	25,059
Other	9,704	8,831
Total	$ 137,060	$ 144,417

8. PRODUCT WARRANTIES

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The Company typically provides 1 to 3-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 accrual activity recorded during the nine months ended September 30, 2018 and 2017.

	2018		2017	
Balance at January 1	$	47,517	$	33,978
Provision for warranty accrual	19,050		20,284	
Warranty claims	(13,827)		(11,746)	
Foreign currency translation	(1,057)		2,459	
Balance at September 30	$	51,683	$	44,975

Accrued warranty reported in the accompanying consolidated financial statements as of September 30, 2018 and December 31, 2017 consisted of $22,045 and $25,059 in accrued expenses and other liabilities and $29,638 and $22,458 in other long-term liabilities, respectively.

9. FINANCING ARRANGEMENTS

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

	September 30, 2018		December 31, 2017	
Long-term notes	46,285		48,982	
Less: current portion	(3,654)		(3,604)	
Total long-term debt	$	42,631	$	45,378

At September 30, 2018, the Company has an unsecured long-term note with an outstanding principal balance $21,078, of which, $1,188 is the current portion. The interest on this unsecured long-term note is variable at 1.2% above LIBOR and is fixed using an interest rate swap at 2.9% per annum. The unsecured long-term note matures in May 2023, at which time the outstanding principal balance will be $15,438. Also at September 30, 2018, the Company has another long-term note that is secured by its corporate aircraft with a outstanding principal balance of $25,207, of which, $2,466 is the current portion. The interest on this collateralized long-term note is fixed at 2.7% per annum. The collateralized long-term note matures in July 2022, at which time the outstanding principal balance will be $15,375.

The Company maintains both a $50,000 and a €50,000 ($58,009) line-of-credit, which are available to certain foreign subsidiaries and allow for borrowings in the local currencies of those subsidiaries. It also maintains a €2,000 ($2,320) overdraft facility. At September 30, 2018 and December 31, 2017, there were no amounts drawn on the U.S. line-of-credit, and there were $955 and $520, respectively, of guarantees issued against the facility which reduce the amount of the facility available to draw. At September 30, 2018 and December 31, 2017, there were no amounts drawn on the Euro line-of-credit, and there were $1,222 and $798, respectively, of guarantees issued against those facilities which reduce the amount available to draw. At September 30, 2018 and December 31, 2017, there were no amounts drawn on the Euro overdraft facility. After providing for the guarantees used, the total unused credit lines and overdraft facilities are $108,152 at September 30, 2018.

10. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative instruments **–** The Company's primary market exposures are to interest rates and foreign exchange rates. The Company from time to time may use 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. During the second quarter of 2018, the Company entered into foreign currency forward contracts to hedge the value of intercompany dividends declared in Euros by the Company's German subsidiary. The dividends were paid in the second and third quarters of 2018. These contracts were not designated as hedging instruments for accounting purposes. There are no foreign currency forward contracts outstanding at September 30, 2018. The Company also has an interest rate swap that is classified as a cash flow hedge of its variable rate debt.

The fair value amounts in the consolidated balance sheets were:

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	Notional Amounts[1]		**Other Assets**		**Other Current Liabilities**	
	September 30, 2018	**December 31, 2017**	**September 30, 2018**	**December 31, 2017**	**September 30, 2018**	**December 31, 2017**
Derivative designated as a cash flow hedge:						
Interest rate swap	$ 21,078	$ 21,969	$ 13	$ 16	$ —	$ —

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

Gains associated with derivative instruments not designated as hedging instruments are as follows: