IPG PHOTONICS CORP
Form DEF 14A
April 07, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
SCHEDULE 14A
Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934
Filed by the Registrant ý
Filed by a Party other than the Registrant ¨
Check the appropriate box:

¨ Preliminary Proxy Statement

¨ Confidential, for Use of the Commission Only (as permitted by Rule 14a- 6(e)(2))

ý Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

IPG PHOTONICS CORPORATION
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)
Payment of Filing Fee (Check the appropriate box):

ý No fee required.
¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
(1) Title of each class of securities to which transaction applies:
(2) Aggregate number of securities to which transaction applies:
(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
(4) Proposed maximum aggregate value of transaction:
(5) Total fee paid:
¨ Fee paid previously with preliminary materials.
¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.
(1) Amount Previously Paid:
(2) Form, Schedule or Registration Statement No.:
(3) Filing Party:
(4) Date Filed:

April 7, 2015
Dear Fellow Stockholder:
You are cordially invited to attend our annual meeting of stockholders on June 2, 2015. We will hold the meeting at 10:00 a.m. Eastern Time at our world headquarters, 50 Old Webster Road, Oxford, Massachusetts 01540.
At this year's meeting, you will be asked to elect nine directors to our Board of Directors for a term of one year, to amend our 2006 Incentive Compensation Plan, to cast an advisory vote to ratify the appointment of our independent registered public accounting firm for 2015 and to transact any other business properly brought before the meeting. Our board of directors recommends that you approve each of these proposals. I urge you to read the proxy statement for further details about the proposals.

A notice of the annual meeting, a proxy statement, proxy card and our 2014 annual report to stockholders, which provide detailed information relating to our activities and operating performance, accompany this letter.

This year, we are delivering our proxy statement and 2014 annual report pursuant to the Securities and Exchange Commission rules that allow companies to furnish proxy materials to their stockholders over the internet. We believe that adopting this process will expedite stockholders' receipt of proxy materials and also lower the cost and environmental impact of our annual meeting. On or about April 14, 2015, we will mail to our stockholders a notice containing instructions on how to access our proxy materials online. In addition, this proxy statement and the notice mailed to stockholders includes instructions on how you can receive a paper copy of our proxy materials.
Whether or not you plan to attend the annual meeting of stockholders, we encourage you to cast your vote by completing, signing and dating the enclosed proxy card and returning it promptly in the envelope provided. You may also vote your shares using the internet or the telephone by following the instructions provided on the enclosed proxy card.
Sincerely,

Dr. Valentin P. Gapontsev
Chairman of the Board of Directors and
Chief Executive Officer

Table of Contents

	Page
Notice of Annual Meeting of Stockholders	1
Proxy Summary	2
General Information About the Meeting	6
Corporate Governance	10
Related Person Transactions	15
Board of Directors	16
Director Compensation	23
Proposal 1: Election of Directors	25
Common Stock Ownership	26
Executive Officers	28
Compensation Committee Report	29
Compensation Discussion and Analysis	30
Executive Compensation Tables	41
Equity Compensation Plans	48
Proposal 2: Amendment of 2006 Incentive Compensation Plan	50
Audit Committee Report	61
Proposal 3: Ratification of Independent Registered Public Accounting Firm	62
Other Matters	64
Appendix A: 2006 Incentive Compensation Plan	A-1

IPG PHOTONICS CORPORATION
50 Old Webster Road
Oxford, Massachusetts 01540
NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To the Stockholders:
We invite you to attend our annual meeting of stockholders which is being held as follows:

Date:	June 2, 2015
Time:	10:00 a.m. Eastern Time
Location:	IPG Photonics Corporation 50 Old Webster Road Oxford, Massachusetts 01540

At the meeting, we will ask our stockholders to:
1 elect nine directors named in the proxy to serve until our 2015 annual meeting of stockholders;
2 amend our 2006 Incentive Compensation Plan; and
3 cast an advisory vote to ratify the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2015.

Stockholders will also transact any other business that may properly come before the meeting.
You may vote on these matters in person or by proxy. Whether or not you plan to attend the meeting, we ask that you promptly vote your shares. Only stockholders of record at the close of business on April 6, 2015 may vote at the meeting.

By order of the Board of Directors
IPG PHOTONICS CORPORATION

Angelo P. Lopresti
Secretary
April 7, 2015
Oxford, Massachusetts
Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting to be held on June 2, 2015:
The proxy statement and 2014 annual report to stockholders are available at:
www.edocumentview.com/ipgp
If you want to receive a paper copy or e-mail of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy to our Investor Relations at ipgp@investorrelations.com or by telephone (617) 542-5300. Please make your request on or before May 22, 2015 to facilitate timely delivery.

PROXY SUMMARY

This summary highlights information available within our proxy statement. You should consider all of the information available in the proxy statement prior to voting your shares. Additional information on the Company's performance in 2014 can be found in our 2014 annual report to stockholders.

2014 Annual Meeting Information

Time and Date: 9:00 a.m. Eastern Time on Tuesday, June 2, 2015

Location: IPG Photonics Corporation, 50 Old Webster Road, Oxford, Massachusetts, 01540

Record Date: April 6, 2015

Voting: Stockholders as of the record date are entitled to vote. Each share of common stock is entitled to one vote for each director nominee and one vote for each other proposals to be voted on.

Voting Your Shares

We encourage you to vote by proxy, even if you plan to attend the annual meeting. Your vote is important and will contribute to the future of IPG. You can vote your shares using one of the following methods:

- Completing and mailing the enclosed proxy card
- Calling (800) 652-8683
- Visiting www.investorvote.com/ipgp
- In person at the annual meeting

If you own shares through a bank, broker, trustee, nominee, or other institution, they will provide you with our proxy statement and any other solicitation materials, as well as voting instructions.

Items of Business

Item Number	Description	Board Vote Recommendation
1	Elect nine directors named in the proxy to serve until our 2015 annual meeting of stockholders	FOR
2	Amend our 2006 Incentive Compensation Plan	FOR
3	Advisory vote to ratify the Company's independent registered public accounting firm	FOR

Election of Directors (Proposal No. 1)

IPG Photonics is recommending the election of nine of the current directors on its Board. The following table provides summary information about each director nominee standing for re-election to the Board. Additional information for all of our directors, including the nominees, may be found beginning on page 16.

Name	Age	Director Since	Principal Occupation	Independent	Committee Memberships	Experience and Skills
Valentin P. Gapontsev, Ph.D.	76	1990	CEO and Chm. of Bd., IPG Photonics Corporation	No	None	• Executive management • Technology • Markets and Applications
Eugene Scherbakov, Ph.D.	67	2000	Managing Director, IPG Laser GmbH	No	None	• Operations • Technology • Markets and Applications
Igor Samartsev	52	2006	Chief Technology Officer, IPG Photonics Corporation	No	None	• Technology • Executive Management
Michael C. Child	60	2000	Senior Advisor, TA Associates, Inc.	Yes	Audit NCG*	• Management and Operations • Mergers & Acquisitions • Technology Growth Companies
Henry E. Gauthier	74	2006	Former Pres. and Chm., Coherent, Inc.	Yes	Presiding Ind. Dir. Audit	• Laser Industry • Financial Expert • Management and Operations
William S. Hurley	70	2006	Principal W.S. Hurley Financial Consulting	Yes	Audit (Chair) Compensation	• Accounting and Finance • Financial Expert • Management
Eric Meurice	58	2014	Former President, CEO and Chairman, ASML Holding NV	Yes	NCG	• Strategy and Strategic Marketing • International Operations • Technology Growth Companies
John R. Peeler	60	2012	CEO and Chm. of Bd., Veeco Instruments Inc.	Yes	Compensation (Chair) NCG	• Management and Operations • International Operations • Leadership Development

Thomas J. Seifert	51	2014	EVP and CFO, Symantec Corporation	Yes	Audit	• Accounting and Finance • Financial Expert • Technology Growth Companies

* NCG is the Nominating and Corporate Governance Committee.

3

Amend our 2006 Incentive Compensation Plan (Proposal No. 2)

We are asking stockholders to approve amendments to our current 2006 Incentive Compensation Plan (the "Amended Plan") which expires in February 2016. The purpose of the Amended Plan is to motivate employees, non-employee directors and independent contractors by providing an opportunity to acquire cash or equity incentive awards, and to provide a means through which the Company, its affiliates and group companies may attract the highest-quality individuals to the Company and to align the interests of such individuals with the Company's stockholders. The stockholders most recently approved the current plan at the Company's 2011 annual meeting of stockholders. The Company is not requesting stockholders to authorize additional new shares in this proposal, however, it is necessary to submit the Amended Plan to stockholders for approval at this time to extend the duration of the current plan, to approve certain other amendments and to satisfy the stockholder approval requirements of Section 162(m) of the Internal Revenue Code of 1986, as amended. The Amended Plan is modeled after and is substantially similar to the current plan.

Additional information regarding the Amended Plan may be found in the Proposal 2: Approval Of Amendments To IPG Photonics Corporation 2006 Incentive Compensation Plan.

Advisory Vote to Ratify the Independent Registered Public Accounting Firm (Proposal No. 3)

We are asking stockholders to cast a non-binding, advisory vote to ratify the engagement of Deloitte & Touche LLP as our independent external auditor for 2015. Please refer to page 62 for additional details on this proposal. The table below provides a summary of fees for professional services rendered by Deloitte for the past three years ended December 31, 2014, 2013 and 2012.

Types of Fees	2014		2013		2012	
Audit Fees	$	1,391,908	$	1,197,733	$	1,086,580
Audit-Related Fees	$	—	$	37,000	$	146,200
Tax and Other Fees	$	224,501	$	200,000	$	7,500

Corporate Governance Summary
The Board:

- is comprised of 70% independent directors
- has presiding independent director
- is comprised of directors with a broad range of leadership, professional skills, and experience which, when taken as a whole, is invaluable in the execution of our strategic plan
- meets regularly in executive session
- is elected annually
- has stock ownership guidelines to align the interests of directors with stockholders
- adopted a policy that prohibits hedging and limits pledging of our stock by directors
- engages in a self-evaluation process
- adopted a related person transaction policy

The Audit, Compensation, and Corporate Governance Committees:

- are all comprised entirely of independent directors, with the Audit Committee comprised of three "financial experts"
- annually review their charters to ensure that they are continuously aligned with evolving Committee responsibilities
- engage in an annual self-evaluation process
- have active Committee member engagement with each director participating in more than 75% of the applicable Committee meetings

Executive Compensation Summary
The Compensation Committee:

- is comprised entirely of independent directors who oversee the executive compensation program
- retains an independent compensation consultant to advise the Committee on the executive compensation program and other compensation matters
- annually reviews the executive compensation program to align it with the stockholder interests
- aligns executive pay with performance consistent with our pay-for-performance philosophy
- balances short-term and long-term incentives including multiple measures of performance
- uses long-term incentives to link executive pay to IPG performance

- designs the compensation program to maximize stockholder value while mitigating short-term risk taking
- caps the maximum amount that can be earned for short-term incentives

The Named Executive Officers:

- have a majority of total direct compensation tied to performance, thereby aligning a significant portion of executive compensation payouts with the interest of stockholders
- have no retirement benefits and limited perquisites
- do not receive excise tax gross-up protections
- may not hedge Company stock and are allowed limited pledging
- do not receive single-trigger change of control provisions
- comply with stock ownership guidelines to align the interests of officers with stockholders
- are subject to clawback provisions

PROXY STATEMENT
ANNUAL MEETING OF STOCKHOLDERS

GENERAL INFORMATION ABOUT THE MEETING

Our Board of Directors of IPG Photonics Corporation is soliciting proxies from our stockholders in connection with our annual meeting of stockholders to be held on Tuesday, June 2, 2015 and any and all adjournments thereof. No business can be conducted at the annual meeting unless a majority of all outstanding shares entitled to vote are either present in person or represented by proxy at the meeting. As far as we know, the only matters to be brought before the annual meeting are those referred to in this proxy statement. If any additional matters are presented at the annual meeting, the persons named as proxies may vote your shares in their discretion.

This proxy statement and our 2014 annual report are first being made available on the internet to stockholders of record on or about April 8, 2015 at www.edocumentview.com/ipgp. Information on the website does not constitute part of this proxy statement.

Unless otherwise noted, the information in this proxy statement covers our 2014 fiscal year (or "fiscal 2014"), which ran from January 1, 2014 through December 31, 2014, and, in some cases, our 2013 fiscal year (or "fiscal 2013"), which ran from January 1, 2013 through December 31, 2013.

Questions and Answers about the Meeting and Voting

When and Where Is the Annual Meeting?

When:	Tuesday, June 2, 2015, at 10:00 a.m. Eastern Time
Where:	IPG Photonics Corporation 50 Old Webster Road Oxford, Massachusetts 01540

What Matters Am I Being Asked to Vote On at the Meeting and What Vote is Required to Approve Each Matter?

You are being asked to vote on three proposals.

Proposal 1 requests the election of directors. Each director will be elected by the vote of the plurality of the votes cast when a quorum is present. A "plurality of the votes cast" means that the nine persons receiving the greatest number of votes cast "for" will be elected. "Votes cast" excludes "withhold votes" and any broker non-votes (as defined below). Accordingly, withhold votes and broker non-votes will have no effect on Proposal 1. If you hold your shares in "street name", it is critically important that you submit your voting instructions to your bank or broker if you want your shares to count for Proposal 1.

Proposal 2 requests the approval of an amendment to our 2006 Incentive Compensation Plan.

Proposal 3 requests the ratification, in an advisory vote, of the appointment of our independent registered public accounting firm.

The affirmative vote of a majority of the shares which are present at the meeting in person or by proxy, and entitled to vote thereon, is required for approval of Proposals 2 and 3. Abstentions have the same effect as voting against Proposals 2 and 3. Broker non-votes have no effect on Proposal 2. Accordingly, if you hold your shares in

street name, you should submit your voting instructions to your bank or broker if you want your shares to count for Proposal 2.

Who Is Entitled to Vote at the Meeting?

You are entitled to vote at the meeting if you owned IPG Photonics shares (directly or in "street name," as defined below) as of the close of business on April 6, 2015, the record date for the meeting. On that date, 52,615,597 shares of our common stock were outstanding and entitled to vote and no shares of our preferred stock were outstanding. Each share of our common stock is entitled to one vote with respect to each matter on which it is entitled to vote; there is no cumulative voting with respect to any proposal.

What Do I Need to Do If I Plan to Attend the Meeting in Person?

If you plan to attend the annual meeting in person, you must provide proof of your ownership of our common stock and a form of personal identification, such as a driver's license, for admission to the meeting. If you are a stockholder of record, the top half of your proxy card is your admission ticket and will serve as proof of ownership. If you hold your shares in street name, a recent brokerage statement or a letter from your bank or broker are examples of proof of ownership. If you hold your shares in street name and you also wish to be able to vote at the meeting, you must obtain a proxy, executed in your favor, from your bank or broker.

What Is the Difference Between Holding Shares Directly as a Stockholder of Record and Holding Shares in "Street Name" at a Bank or Broker?

Most of our stockholders hold their shares directly through a broker, bank or other nominee rather than directly in their own name. As summarized below, there are differences between shares held of record and those held in "street name."

Stockholder of Record: If your shares are registered directly in your name with our transfer agent, Computershare, N.A., you are considered the stockholder of record with respect to those shares, and the proxy statement and annual report were sent directly to you. As the stockholder of record, you have the right to vote your shares as described herein.

"Street Name" Stockholder: If your shares are held by a bank or broker as your nominee, you are considered the beneficial owner of shares held in "street name," and the proxy statement and annual report were forwarded to you by your bank or broker who is considered the stockholder of record with respect to those shares. Your bank or broker sent to you, as the beneficial owner, a document describing the procedure for voting your shares. You should follow the instructions provided by your bank or broker to vote your shares. You are also invited to attend the annual meeting. However, if you wish to be able to vote at the meeting, you must obtain a proxy card, executed in your favor, from your bank or broker.

What Does it Mean to Give a Proxy?

Your properly completed proxy/voting instruction card will appoint Valentin P. Gapontsev and Angelo P. Lopresti as proxy holders or your representatives to vote your shares in the manner directed therein by you. Dr. Gapontsev is our Chairman of the Board and Chief Executive Officer. Mr. Lopresti is our Senior Vice President, General Counsel and Secretary. Your proxy permits you to direct the proxy holders to vote "for" or "withhold" for the nominees for director (Proposal 1), and "for," "against," or "abstain" from the amendment of the 2006 Incentive Compensation Plan (Proposal 2) and the advisory vote to ratify the appointment of our independent registered accounting firm (Proposal 3).

All of your shares entitled to vote and represented by a properly completed proxy or voting instruction received prior to the meeting and not revoked will be voted at the meeting in accordance with your instruction.

What Happens If I Sign, Date and Return My Proxy But Do Not Specify How I Want My Shares Voted on One of the Proposals?

Stockholder of Record: Your proxy will be counted as a vote "For" all of the nominees for director and "For" Proposals 2 and 3.

"Street Name" Stockholder: Your bank, broker or nominee may vote your shares only on those proposals on which it has discretion to vote. Under New York Stock Exchange rules, your bank, broker or nominee does not have discretion to vote your shares on non-routine matters such as the election of directors (Proposal 1) and the

amendment of our 2006 Incentive Compensation Plan (Proposal 2). This is called a "broker non-vote." However, your bank, broker or nominee does have discretion to vote your shares on routine matters such as the advisory vote to ratify the appointment of our independent registered public accounting firm (Proposal 3). Accordingly, if you do not give your bank, broker or nominee specific instructions with respect to Proposal 3, your shares will be voted in such entity's discretion (but only with respect to Proposal 3). We urge you to promptly provide your bank, broker or nominee with appropriate voting instructions so that all of your shares may be voted at the meeting.

Can I Change My Vote Before the Meeting?

You can change your vote at any time before your proxy is exercised by delivering a properly executed, later-dated proxy (including an Internet or telephone vote), by revoking your proxy by written notice to the Secretary of IPG Photonics, or by voting in person at the meeting. If you choose to revoke your proxy by attending the annual meeting, you must vote your shares for revocation to be effective. The method by which you vote by a proxy will in no way limit your right to vote at the meeting if you decide to attend in person.

If your shares are held in street name, please refer to the information forwarded by your bank, broker or nominee for procedures on changing your voting instructions.

Is the Proxy Statement Available on the Internet?

Yes. Beginning this year, we are delivering our proxy statement and 2014 annual report pursuant to the Securities and Exchange Commission rules that allow companies to furnish proxy materials to their stockholders over the internet. On or about April 14, 2015, we will mail to our stockholders a notice (the “Notice”) containing instruction on how to access this proxy statement and our annual report and to vote via the internet or by telephone. Stockholders can view these documents on the Internet by accessing the website at www.edocumentview.com/ipgp.

What does it mean if I receive more than one Notice of Internet Availability of Proxy Materials?

You may receive more than one Notice, more than one e-mail or multiple proxy cards or voting instruction cards. For example, if you hold your shares in more than one brokerage account, you may receive a separate Notice, a separate e-mail or a separate voting instruction card for each brokerage account in which you hold shares. If you are a stockholder of record and your shares are registered in more than one name, you may receive more than one Notice, more than one e-mail or more than one proxy card. To vote all of your shares by proxy, you must complete, sign, date and return each proxy card and voting instruction card that you receive and vote over the internet the shares represented by each Notice that you receive (unless you have requested and received a proxy card or voting instruction card for the shares represented by one or more of those Notices).

Who Is Soliciting my Proxy and Who is Paying for the Cost of this Proxy Solicitation?

The Board of Directors of IPG Photonics is soliciting your proxy to vote at the 2015 annual meeting of stockholders. IPG Photonics will bear the expense of preparing, posting to the internet, printing and mailing this proxy material, as well as the cost of any required solicitation. Our directors, officers or employees may solicit proxies on our behalf. We have not engaged a proxy solicitation firm to assist us in the solicitation of proxies, but we may if we deem it appropriate. In addition, we will reimburse banks, brokers and other custodians, nominees and fiduciaries for reasonable expenses incurred in forwarding proxy materials to beneficial owners of our stock and obtaining their proxies.

Who Counts the Votes?

We have engaged Computershare as our independent agent to receive and tabulate stockholder votes. Computershare will separately tabulate "for," "against" and "withhold" votes, abstentions and broker non-votes. Computershare will also act as independent election inspector to certify the results, determine the existence of a quorum and the validity of proxies and ballots, and perform any other acts required under the General Corporation Law of Delaware.

How Can I Vote?

Most stockholders have a choice of voting in one of four ways:

- via the internet;
- using a toll-free telephone number;
- completing a proxy/voting instruction card and mailing it in the postage-paid envelope provided; or

• in person at the meeting.

The telephone and Internet voting facilities for stockholders of record will close at 1:00 a.m. Central Time on June 2, 2015. The Internet and telephone voting procedures are designed to authenticate stockholders by use of a control number and to allow you to confirm that your instructions have been properly recorded.

If you hold your shares in street name, your bank or broker will send you a separate package describing the procedures and options for voting your shares. Please read this information carefully. If you hold your shares in street name, and wish to vote in person at the annual meeting, you must obtain a "legal proxy" from the organization that holds your shares. A legal proxy is a written document that will authorize you to vote your shares held in street name at the annual meeting. Please contact the organization that holds your shares for instructions regarding obtaining a legal proxy. You must bring a copy of the legal proxy to the annual meeting and ask for a ballot when you arrive.

What Is the Quorum Required to Transact Business?

At the close of business on April 6, 2015, the record date, there were 52,615,597 shares of our common stock outstanding. Our by-laws require that a majority of our common stock be represented, in person or by proxy, at the meeting in order to constitute the quorum we need to transact business at the meeting. We will count withhold votes, abstentions and broker non-votes in determining whether a quorum exists.

CORPORATE GOVERNANCE

At IPG Photonics, we believe that strong and effective corporate governance procedures and practices are an extremely important part of our corporate culture. We have summarized several of our corporate governance practices below.

Significant Corporate Governance Practices and Policies

At IPG Photonics, we believe that strong and effective corporate governance procedures and practices are an extremely important part of our corporate culture. We have summarized several of our corporate governance practices below.

- Independent Director Majority and Presiding Independent Director. Seven of the ten directors currently on our Board of Directors (the "Board") are non-employees of the Company who meet the independence criteria under applicable rules of the Securities and Exchange Commission ("SEC") and NASDAQ guidelines. Only independent directors sit on our three standing Board committees. Several years ago, the Board established the role of a presiding independent director who is elected annually by the independent directors.

- Executive Sessions. Our Board meets regularly in executive sessions without the presence of management, including our Chief Executive Officer. These sessions are led by our Presiding Independent Director.

- Annual Election of Entire Board. Stockholders elect each director annually. We do not have a classified board.

- Related Person Transactions. Our Nominating and Corporate Governance Committee is responsible for approving or ratifying transactions involving our Company and related persons and determining if the transaction is in, or not inconsistent with, the best interests of our Company and our stockholders.

- Stock Ownership Guidelines. Our directors and executive officers are required to own a minimum amount of IPG Photonics shares. In 2014, our Board increased the stock ownership requirements to our Chief Executive Officer to five times his base salary. We believe that stock ownership requirements align the interest of the directors and officers with our stockholders. Our directors and executive officers fully complied with our guidelines in 2014.

- Prohibition on Hedging; Limits on Pledging. Our insider trading policy expressly prohibits directors and employees from engaging in short sales of our common stock or buying or selling puts, calls or derivative securities in connection with IPG Photonics shares.

- Annual Self-Assessments. Our Board engages in annual self-evaluations to determine if it and its committees are functioning effectively.

Additional information is provided below regarding these and certain other key corporate governance policies, which we believe enable us to manage our business in accordance with high standards of business practices and in the best interest of our stockholders. Several of our policies may be found at http://investor.ipgphotonics.com/governance.cfm. Note that information on our website does not constitute part of this proxy statement.

Corporate Governance Guidelines

Our Board has adopted Corporate Governance Guidelines that outline, among other matters, the roles and functions of the Board, the responsibilities of various Board committees and the mission of the Board. Each of the Board committees has a written charter that sets forth the purposes, goals and responsibilities of the committees as well as qualification for committee membership, procedures for committee membership, appointment and removal, committee structure and operations and committee reporting to the entire Board.

The Governance Guidelines provide, among other things, that:

- a majority of our Board must be independent;
- the Presiding Independent Director presides over executive sessions of independent directors;

10

- the Board appoints all members and chairpersons of the Board committees;
- the Audit, Compensation, and Nominating and Corporate Governance Committees consist solely of independent directors;
- the independent directors meet periodically in executive sessions without the presence of the non-independent directors or members of our management;
- directors may not serve on the boards of more than three other public companies;
- evaluations of the Board and committees are conducted annually; and
- the Board and key officers should have a meaningful financial stake in the Company.

The Board reviews changing legal and regulatory requirements, evolving best practices and other developments. The Board modifies the Governance Guidelines and its other corporate governance policies and practices from time to time, as appropriate.

Executive Sessions. Our independent directors meet privately, without employee directors or management present, at least four times during the year. These private sessions are generally held in conjunction with the regular quarterly Board meetings. Other private meetings are held as often as deemed necessary by the independent directors. The Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee meet without employee directors or management present from time to time as they deem necessary.

Director Meetings and Policy Regarding Board Attendance. It has been the practice of our Board and its committees to hold at least four in-person regular meetings each year. The Board and its committees also have telephone meetings throughout the year. In accordance with our Governance Guidelines, our directors are expected to prepare for, attend and actively participate in meetings of the Board and its committees. Our directors are expected to spend the time needed at each meeting and to meet as frequently as necessary to properly discharge their responsibilities. We encourage members of our Board to attend annual meetings of stockholders, but we do not have a formal policy requiring them to do so.

Stock Ownership Guidelines. The Board adopted stock ownership guidelines to more closely align the interests of our directors and executive officers with those of our long-term stockholders. Under the guidelines, the following persons are expected to maintain a minimum investment in our common stock as follows: for non-employee directors, the lesser of 3,000 shares or three times their annual cash Board retainer (excluding committee retainers); for the Chief Executive Officer, five times his annual salary; and for other executive officers, the lesser of 5,000 shares or one times their respective annual salaries. In 2014, the Board approved an increase in stock ownership requirements for the Chief Executive Officer to the level stated in the previous sentence. Vested equity compensation such as vested stock options counts towards the stock ownership levels. Indirect ownership of shares through a separate legal entity counts toward fulfillment of the ownership guidelines. These ownership levels are to be achieved no later than four years after the election as a director or as an executive officer, except that prior to such time the director or officer is expected to retain a certain portion of stock issued upon exercise of stock options or vesting of restricted stock awards until the minimum ownership levels are attained. All directors and executive officers were in compliance with our stock ownership guidelines as of December 31, 2014.

Board Self-Assessments. The Board conducts annual self-evaluations to determine whether it and its committees are functioning effectively. The Nominating and Corporate Governance Committee oversees the Board and committee self-assessments and the Board receives a report on its self-assessments annually. Each committee also annually reviews its own performance and reports the results to the Board. Each committee reviews and reassesses the adequacy of its charter annually and recommends any proposed changes.

Prohibition on Hedging; Limits on Pledging. Under our insider trading policy, no director or employee may engage in shorting shares of our common stock, or buying or selling puts, calls or derivatives related to our common stock. A director or officer of the Company may not pledge shares constituting more than 20% of his or her total stock ownership. Pledges of shares constituting 20% or less of total stock ownership are subject to certain conditions.

Governance Trends and Director Education. The Board and its Committees proactively monitor legislative and regulatory initiatives, as well as other corporate governance trends and their potential impact on the Company. Each director has access to publications and other resources that cover these matters. In addition, we enroll our directors as members of the National Association of Corporate Directors and reimburse relevant director education expenses.

In 2014, the Board received a presentation from professionals in the financial community on various topics including the current macro-economic outlook, market trends, mergers and acquisition trends, industry fundamentals,

current valuations, investor perception, industry framework and current industry topics. In previous years, experts in the areas of corporate governance and law have spoken to the Board on regulatory actions, governance trends and various other corporate governance topics. Directors participated in continuing education sessions to remain informed on recent trends applicable to their Committee duties. Newly elected directors participate in a comprehensive director orientation program that covers, among other things, our strategy, business structure, financial performance, and competitive landscape. New committee members are also provided with training on committee policies, practices and trends. As part of this program, directors are invited to participate in a tour of selected facilities of the Company. To further familiarize directors with our operations, we conduct Board meetings at our major facilities from time to time. The Committees actively engage with senior management and other parties when necessary to further assess the current environment or respond to governance related matters. The Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee each routinely receive updates on matters applicable to their responsibilities from legal counsel, auditors and independent consultants.

Nomination of Directors. The Nominating and Corporate Governance Committee considers candidates for director nominees proposed by directors and stockholders. This Committee may retain recruiting professionals and use director databases to assist in identifying and evaluating candidates for director nominees. The Board seeks members from diverse professional backgrounds with a reputation for integrity who do not have professional commitments that might unreasonably interfere with the demands and duties of a board member. Candidates for director are reviewed in the context of the current composition of the Board, the operating requirements of the Company and the long-term interests of the Company's stockholders. The Nominating and Governance Committee seeks directors with a broad spectrum of experience and expertise. It seeks a Board that reflects diversity, including in experience, gender and ethnicity. It does not have formal objective criteria for determining the degree of diversity needed or present on the Board. Board candidates are considered based upon various criteria, such as demonstrated excellence, leadership and significant experience in an area of endeavor, relevant expertise and experience and the ability to offer advice and guidance based upon that expertise, possession of high personal integrity and ethics, ability to read and understand financial statements, a commitment to representing the long-term interests of the Company's stockholders while keeping in perspective the interests of customers, suppliers and employees, and any other factors appropriate in the context of an assessment by the Nominating and Corporate Governance Committee of the needs of the Board at that time. Candidates for director should also have certain minimum qualifications, including the ability to read and understand basic financial statements, must be over 21 years of age and possess the highest personal integrity and ethics. In addition, the Nominating and Corporate Governance Committee considers whether the individual satisfies criteria for independence as may be required by applicable regulations. The Nominating and Corporate Governance Committee retained the search firm Heidrick & Struggles to assist in the search and evaluation of candidates for director which resulted in the nomination of Mr. Eric Meurice and Mr. Thomas Seifert who were elected to the Board at our 2014 annual meeting.

The Nominating and Corporate Governance Committee has adopted a policy under which it will consider nominations by stockholders. The same identifying and evaluating procedures apply to all candidates for director nomination, including candidates submitted by stockholders. The Nominating and Corporate Governance Committee evaluates and interviews potential board candidates. All members of the Board may interview the final candidates.

Code of Business Conduct. We have a code of business conduct that applies to all of our directors and employees, including our Chief Executive Officer, Chief Financial Officer and other executive officers. Our code of business conduct includes provisions covering conflicts of interest, business gifts and entertainment, outside activities, compliance with laws and regulations, insider trading practices, antitrust laws, payments to government personnel, bribes or kickbacks, corporate record keeping and accounting records. The code of business conduct is posted on our website at http://investor.ipgphotonics.com/governance.cfm.

Procedures for Submitting Complaints. We have procedures for the treatment of complaints regarding accounting, internal accounting controls, auditing matters, fight against bribery, banking, and financial crime, including procedures for the confidential and anonymous submission by our directors, officers and employees of concerns regarding questionable accounting, internal accounting controls or auditing matters. These procedures are posted on our website at http://investor.ipgphotonics.com/governance.cfm.

Board Leadership Structure

As of the date of this proxy statement, the positions of Chairman of the Board and Presiding Independent Director are held by two different individuals. Dr. Gapontsev, our Chief Executive Officer, also serves as the Chairman of the Board. Our independent directors determined several years ago that, for effective board governance, it is important to have a presiding independent director. Mr. Gauthier has been selected as the Presiding Independent Director for a term ending June 2015.

Dr. Gapontsev became our Chief Executive Officer and Chairman in 1998. His dual role was established sixteen years ago when the Board was first established. Our directors believe that each of the possible leadership structures for a board has its particular pros and cons which much be considered in the context of the specific circumstances, culture and challenges facing a company, and that such consideration is the responsibility of a company's board that has a diversity of views and experiences. Our directors come from a variety of organizational backgrounds and have direct experience with a wide range of leadership and management structures. The makeup of our Board puts it in a very strong position to evaluate the pros and cons of the various types of board leadership structures and to ultimately decide which structure is in the best interests of our stockholders.The independent directors believe that having Dr. Gapontsev serve in both capacities is in the best interest of the Company and its stockholders because it allows Dr. Gapontsev to more effectively execute the Company's strategic initiatives and business plans. He is the founder of the Company and beneficially owns approximately 14.0% of the Company's common stock. The combination of the roles of Chairman and Chief Executive Officer in Dr. Gapontsev creates clear and unambiguous authority, which is essential to effective management. The Board and management can respond more effectively to a clear line of authority. Further, given that he is closer to the Company's business than any other Board member and he has the benefit of over fifteen years of operations and leadership experience within the Company, Dr. Gapontsev is best-positioned to set the Board's agenda and provide leadership. Dr. Gapontsev's extensive scientific and business experience also gives him vast industry knowledge, which the Board believes is critical for the chairman of the board of a company that operates in a highly technical industry. The combined Chairman/Chief Executive structure is a leadership model that has served our stockholders well for many years.

The Board also recognized the importance for a board to have in place, and build upon, a counterbalancing structure to ensure that it functions in an appropriately independent manner. As a result, the Board enhanced its governance structure several years ago by creating the position of Presiding Independent Director with leadership authority and responsibilities. The duties and responsibilities of the Presiding Independent Director include: setting the agenda for, and leading, executive sessions of the independent directors; providing consolidated feedback from those meetings to the Chairman and Chief Executive Officer; providing input on the agenda for Board meetings; periodically providing feedback on the quality and quantity of information flow from management; having the authority to call meetings of the independent directors; facilitating discussions outside of scheduled Board meetings among the independent directors on key issues as required; serving as a non-exclusive liaison with the Chairman and Chief Executive Officer in consultation with the other independent directors; interviewing Board candidates as appropriate; and, commencing in 2014, leading the determination of the goals and objectives for the Chairman and Chief Executive Officer with the input of the independent directors and the annual performance evaluation for him with the input of the independent directors and providing that evaluation to the Compensation Committee. In the event of a crisis, the Presiding Independent Director would have an increased role in crisis management oversight. The independent directors of our Board elected Mr. Gauthier as the Presiding Independent Director for the term ending June 2015, and this position is voted upon annually by our independent directors.

The Board believes that the position and responsibilities of a presiding independent director and the regular use of executive sessions of the independent directors without the Chief Executive Officer or other executive officers present, along with the Company's strong committee system and substantial majority of independent directors, allow the Board to maintain effective oversight.

Risk Oversight

The Board and management recognize that effectively monitoring and managing risk are essential to the successful execution of the Company's strategy. The Board reviews strategy regularly with management and provides input to

management. As part of its oversight of operations, the entire Board reviews and discusses the performance of the Company and the principal risks involved in the operations and management of the Company. The Board allocates risk oversight responsibility among the full Board, the independent directors and the three standing committees of the Board. The Nominating and Corporate Governance Committee periodically

reviews risk oversight matters and responsibilities, then makes recommendations to the Board to allocate risk oversight responsibilities.

The Board as a whole reviews risk management practices and a number of significant risks in the course of its reviews of corporate strategy, management reports and other presentations. The independent directors as a group oversee succession and resource planning. The Audit Committee oversees certain financial risks and recommends guidelines to monitor and control such risk exposures. The Compensation Committee reviews the Company's executive compensation programs, their effectiveness at both linking executive pay to performance and aligning the interests of our executives and our stockholders, and oversees an entity-wide compensation risk assessment. The Nominating and Corporate Governance Committee reviews significant related party transactions with directors, executives and managers and may conduct negotiations on behalf of the Company. The Board's risk oversight role is independent from the Company's day-to-day management, as more than two-thirds of the current directors are independent and therefore have no conflicts that might discourage critical review of the Company's risks.

Communication with our Board of Directors

Interested parties wishing to write to the Board, a specified director or a committee of the Board should send correspondence to the Office of the Secretary, IPG Photonics Corporation, 50 Old Webster Road, Oxford, Massachusetts 01540. All written communications received in such manner from stockholders of the Company will be forwarded to the members or committee of the Board to whom the communication is directed or, if the communication is not directed to any particular member(s) or committee(s) of the Board, the communication shall be forwarded to all members of the Board.

RELATED PERSON TRANSACTIONS

The Board adopted a related person transaction policy that requires the Company's executive officers, directors and nominees for director to promptly notify the Corporate Secretary in writing of any transaction in which (i) the amount exceeds $100,000, (ii) the Company is, was or is proposed to be a participant and (iii) such person or such person's immediate family members ("Related Persons") has, had or may have a direct or indirect material interest (a "Related Person Transaction"). Subject to certain exceptions in the policy, Related Person Transactions must be brought to the attention of the Nominating and Corporate Governance Committee for an assessment of whether the transaction or proposed transaction should be permitted. In deciding whether to approve or ratify the Related Person Transaction, the Nominating and Corporate Governance Committee considers relevant facts and circumstances. If the Nominating and Corporate Governance Committee determines that a Related Person has a direct or indirect material interest in any such transaction, the Committee must review and approve, ratify or disapprove the Related Person Transaction.
Pursuant to our Governance Guidelines, we expect each of our directors to ensure that other existing and future commitments do not conflict with or materially interfere with his or her service as a director. Directors are expected to avoid any action, position or interest that conflicts with our interests or gives the appearance of a conflict. In addition, directors are required to inform the chairman of our Nominating and Corporate Governance Committee prior to joining the Board of another public company to ensure that any potential conflicts, excessive time demands or other issues are carefully considered.

The Nominating and Corporate Governance Committee reviewed and approved the following Related Person Transactions which were conducted on an "arm's length" basis with the Company.
The Company leased from an unrelated third party approximately 12,000 square feet of office space in Marlborough, Massachusetts under an office lease expiring November 2017. A subsidiary of IP Fibre Devices (UK) Ltd. ("IPFD") purchased the building in October 2014 and acquired the lease. The Company's CEO is the managing director of IPFD, and IPFD is a stockholder of the Company. Messrs. Gapontsev, Samartsev and Scherbakov, and trusts created by Dr. Gapontsev own shares of IPFD. See the table and notes in the section titled "Common Stock Ownership." The 2014 year-end annual lease rate was $232,000 with annual increase of approximately 2.5% per year. The Company reimburses the landlord for its portion of certain operational costs. The Company paid IPFD $20,000 under the office lease for 2014.
Dr. Gapontsev leases the annual right to use 25% of the Company's corporate aircraft under a October 2014 lease expiring November 2019. The 2014 year-end annual lease rate was $684,000 and future rent payments will be adjusted annually. Dr. Gapontsev also pays direct and incidental operating costs for his private use including pilot fees. He paid the Company $146,000 in 2014 under the aircraft lease.
In 2014, the Company sold products and services of $2,731,000 to OAO "RCE" Laser Processing Center ("Laser Center"), an application development and parts processing company. Dr. Gapontsev owns approximately 39% of Laser Center, which he acquired from an unrelated third party in 2014.

In 2014, the Company purchased from Veeco Instruments Inc. equipment and services amounting to approximately $3,687,000. Mr. Peeler, a non-employee member of our Board, is the Chief Executive Officer and Chairman of the Board of Veeco Instruments Inc. For several years before Mr. Peeler was elected to the Board, Veeco Instruments, Inc. was a provider of equipment and services to the Company.

The Nominating and Corporate Governance Committee reviewed and approved the foregoing transactions which were ordinary course business transactions conducted on an "arm's length" basis with the Company.

BOARD OF DIRECTORS

The Board currently set the number of directors at ten, but the number of directors will be set at nine from and after the 2015 annual meeting. Mr. Robert Blair decided to not stand for re-election to our Board of Directors at our 2015 annual meeting. IPG Photonics extends its sincere appreciation to Mr. Blair for the valuable contributions he provided to our Company and stockholders during his service as a member of our Board since 2000.

Nominees for Director

The following table sets forth certain information as of the date of this proxy statement regarding the director nominees. Each of our incumbent directors, other than Mr. Blair, has been nominated by the Board for election at our 2015 annual meeting.

Valentin P. Gapontsev, Ph.D.

Director since 1998
Chief Executive Officer and Chairman of the Board
Age 76

Dr. Gapontsev has been the Chief Executive Officer and Chairman of the Board of IPG since out inception. Prior to founding the company in 1990, Dr. Gapontsev served as senior scientist in laser material physics and head of the laboratory at the Soviet Academy of Science's Institute of Radio Engineering and Electronics in Moscow. In 2006, he was awarded the Ernst & Young® Entrepreneur of the Year Award for Industrial Products and Services in New England, and in 2009, he was awarded the Arthur L. Schawlow Award by the Laser Institute of America. In 2011, he received the Russian Federation National Award in Science and Technology, and he was selected as a Fellow of the Optical Society of America. Dr. Gapontsev holds a Ph.D. in Physics from the Moscow Institute of Physics and Technology.

Key Attributes, Experience and Skills

He is the founder of the Company and has successfully led the Company and the Board since the Company was formed. In the roles of Chief Executive Officer and Chairman of the Board, he has been responsible for formulation and execution of IPG's strategy and providing leadership and oversight of IPG's business during a period of rapid and profitable growth, as well as business contractions. He has over thirty years of academic research experience in the fields of solid state laser materials, laser spectroscopy and non-radiative energy transfer between rare earth ions and is the author of many scientific publications and several international patents. His strategic foresight and entrepreneurial spirit along with his deep scientific understanding has guided the Company's continued growth and technology leadership. Under Dr. Gapontsev's leadership, the Company continues to generate strong revenue and earnings growth.

Eugene Scherbakov, Ph.D.

Director since 2000
Managing Director of IPG Laser GmbH and Senior Vice President
Age 67

Dr. Scherbakov has served as Managing Director of IPG Laser GmbH, our German subsidiary, since August 2000 and Senior Vice President-Europe since February 2013. He served as the Technical Director of IPG Laser from 1995 to August 2000. From 1983 to 1995, Dr. Scherbakov was a senior scientist in fiber optics and head of the optical communications laboratory at the General Physics Institute, Russian Academy of Science in Moscow. Dr. Scherbakov graduated from the Moscow Physics and Technology Institute with an M.S. in Physics. In addition, Dr. Scherbakov attended the Russian Academy of Science in Moscow, where he received a Ph.D. in Quantum Electronics from its Lebedev Physics Institute and a Dr.Sci. degree in Laser Physics from its General Physics Institute.

Key Attributes, Experience and Skills

Dr. Scherbakov has extensive knowledge of the Company's business as Managing Director of IPG Laser GmbH, which produces a large volume of our products and is the source of many developments in products, technology and applications. The leadership and operational expertise of Dr. Scherbakov have contributed to IPG increasing production, lowering manufacturing costs and maintaining high margins compared to our industry peers. He also

has extensive technological knowledge of fiber lasers, their components and the manufacturing process. His service as an executive officer of the Company provides the Board with a detailed understanding of the Company's operations, sales and customers.

Igor Samartsev

Director since 2006
Chief Technology Officer
Age 52
Since 2011, Mr. Samartsev has served our Chief Technology Officer and since 2005, he was the Deputy General Manager of our Russian subsidiary, NTO IRE-Polus. Prior to that time, he served in technical leadership roles at NTO IRE-Polus. Mr. Samartsev holds an M.S. in Physics from the Moscow Institute of Physics and Technology.

Key Attributes, Experience and Skills
Mr. Samartsev is one of the founders of the Company and has a significant management role in the Company as Chief Technology Officer. As one of the key developers of the technology platform of the Company and leader in the development of many new optical technologies and products that form part of the Company's strategic plan, the Board values Mr. Samartsev's understanding of technology developments at our company.

Michael C. Child

Director since 2000
Independent Director
Age 60
Audit Committee
Nominating and Corporate Governance Committee
Directorship at Other Public Companies: Finisar Corporation and Ultratech Inc.
Since July 1982, Mr. Child has been employed by TA Associates, Inc., a private equity investment firm, where he currently serves as Senior Advisor and, prior to January 2011, he was Managing Director. Mr. Child holds a B.S. in Electrical Engineering from the University of California at Davis and an M.B.A. from the Stanford University Graduate School of Business.

Key Attributes, Experience and Skills
Mr. Child is an established and experienced investor, including in technology companies, from his three decades of experience at TA Associates, Inc., a private equity investment firm. Over the course of his career, he has overseen numerous investments and sales of portfolio companies, and served on the boards of public and private companies. He now serves on the boards of Finisar Corporation, a developer and manufacturer of optical subsystems and components for networks, and Ultratech Inc., a developer and manufacturer of advanced packaging lithography systems and laser processing technologies. Through his experiences, he has gained valuable knowledge in the management, operations and finance of technology growth companies.

Henry E. Gauthier

Director since 2006
Independent Director
Age 74
Presiding Independent Director
Audit Committee - Audit Committee Financial Expert

He served as Chairman of the board of directors of Coherent, Inc., a manufacturer of photonics products, from February 1997 to October 2002 and was its President from 1983 to 1996. Mr. Gauthier served as Vice Chairman of the board of directors of Coherent, Inc. from October 2002 to March 2006. Mr. Gauthier was President from February 2005 to May 2005, consultant from January 2004 to February 2005 and June 2005 to December 2006, and Chairman of the board of directors from May 2005 to December 2008, of Reliant Technologies, Inc., which was acquired in December 2008 by Solta Medical, Inc., a manufacturer of medical laser systems. Since July 1996, Mr. Gauthier has served as a principal at Gauthier Consulting. Mr. Gauthier attended the United States Coast Guard

Academy, San Jose State University, and the Executive Institute of the Stanford University Graduate Business School.

Key Attributes, Experience and Skills
Mr. Gauthier has extensive management and operational experience in the laser industry from over two decades as an executive pf a large publicly-held laser company, Coherent, Inc., as well as emerging growth companies such as Reliant Technologies, Inc. He has obtained an in-depth knowledge of operations, manufacturing, sales and markets, and finances through his CEO positions at these laser-related companies. Having been a past member of the audit, compensation, and nominating and corporate governance committees of public and private company boards in the technology field, Mr. Gauthier is familiar with a full range of corporate and board functions and lends this experience to the Company's Board as an independent director and the Presiding Independent Director.

William S. Hurley

Director since 2006
Independent Director
Age 70
Audit Committee (Chair) - Audit Committee Financial Expert
Compensation Committee
Mr. Hurley served in several senior financial positions during his career: he was Senior Vice President and Chief Financial Officer at Applied Science & Technology Inc., a developer, manufacturer and supporter of semiconductor capital equipment, from 1999 until 2001; he was Vice President and Chief Financial Officer at Cybex International, Inc., a designer, manufacturer and distributor of fitness equipment, from 1996 to 1999; and from 1992 to 1995 he was Vice President-Controller and Chief Accounting Officer at BBN Corporation, formerly known as Bolt, Beranek & Newman, Inc., a high technology company. Since April 2006, Mr. Hurley has been principal of W.S. Hurley Financial Consulting, which provides supplemental chief financial officer services. He holds a B.S. in Accounting from Boston College and an M.B.A. in Finance from the Columbia University Graduate School of Business.

Key Attributes, Experience and Skills
Mr. Hurley has extensive accounting and financial management experience from his executive and accounting positions with several public and private companies. In addition to being a certified public accountant, he served as a member of an audit committee for over a decade (including several years as chair) and a member of the compensation committee of another publicly-held company. Mr. Hurley possesses a Certificate of Director Education issued by the National Association of Corporate Directors to complement his understanding of corporate governance and the duties of a board of directors. His experiences as an executive in leadership positions and as an independent director have given him the background and skills needed to lead the Audit Committee in its oversight role regarding the reporting of the Company's results of operations, the effectiveness of internal controls and risk management.

Eric Meurice

Director since 2014
Independent Director
Age 58
Nominating and Corporate Governance Committee
Directorship at Other Public Company: NXP Semiconductor N.V.
Mr. Meurice was President and Chief Executive Officer of ASML Holding NV, a provider of semiconductor manufacturing equipment and technology, from October 2004 to June 2013, and Chairman until March 2014. From 2001 to 2004, he was Executive Vice President of the Thomson Television Division of Thomson, SA, an electronics manufacturer. From 1995 to 2001, he served as head of Dell Computer's Western, Eastern Europe and EMEA

emerging market businesses. Before 1995, he gained significant technology experience at ITT Semiconductors and at Intel Corporation. Mr. Meurice served on the boards of Verigy Ltd. (a manufacturer of semiconductor test equipment), until its acquisition by Advantest Corporation in 2011, and ARM Holdings plc (a semiconductor intellectual property supplier) from July 2013 to March 2014. He has been on the board of NXP Semiconductors N.V. (a semiconductor company) since April 2014. Mr. Meurice earned a Master's degree in mechanics and energy generation at the Ecole Centrale de Paris, a Master's degree in Economics from la Sorbonne University, Paris, and an M.B.A. from the Stanford University Graduate School of Business.

Key Attributes, Experience and Skills
Mr. Meurice has extensive skills and experience as a manager of several rapidly-growing, complex and global businesses in the capital equipment and electronics fields with several billions of dollars in revenues, most recently as former President and Chief Executive Officer of ASML. He has experience managing a publicly-held company as well as experience on serving on several public company boards in the equipment and technology fields, such as NXP Semiconductor N.V., Verigy, Ltd. and ARM Holdings plc. Mr. Meurice also has a record of proven leadership as a strategic thinker, operator and marketer at the businesses he managed.

John R. Peeler

Director since 2012
Independent Director
Age 60
Compensation Committee (Chair)
Nominating and Corporate Governance Committee
Directorship at Other Public Company: Veeco Instruments Inc.
Mr. Peeler has been Chief Executive Officer and a director of Veeco Instruments Inc. since July 2007. He has been serving as its Chairman of the Board since May 2012. Veeco is a developer and manufacturer of MOCVD, molecular beam epitaxy, ion beam and other advanced thin film processes equipment. He was Executive Vice President of JDS Uniphase Corp. ("JDSU") and President of the Communications Test & Measurement Group of JDSU, which he joined upon the closing of JDSU's merger with Acterna, Inc. ("Acterna") in August 2005. Before joining JDSU, Mr. Peeler served as President and Chief Executive Officer of Acterna. He has a B.S. and M.E. in Electrical Engineering from the University of Virginia.

Key Attributes, Experience and Skills
Over the course of his career, Mr. Peeler has managed several high-growth technology companies. In addition, he has developed managerial leadership skills through his position as Chief Executive Officer of Veeco, a publicly-traded company with substantial international operations. His managerial positions have provide him with in-depth knowledge of the service needs of customers in demanding markets, including semiconductor capital equipment, various manufacturing models, marketing and sales. In these roles, he has also been responsible for attracting and incentivizing executives on his team. These experiences have provided him valuable insight in support of his position as Chair of the Compensation Committee where he is responsible for leading the development and implementation of compensation pay practices and programs for the Company's executive management.

Thomas J. Seifert

Director since 2014
Independent Director
Age 51
Audit Committee - Audit Committee Financial Expert
Mr.Seifert has been the Executive Vice President and Chief Financial Officer of Symantec Corporation, a provider of security, backup and availability solutions, since March 2014. Mr. Seifert served as Executive Vice President and Chief Financial Officer of Brightstar Corporation, a wireless distribution and services company, from December 2012 to March 2014. He was Senior Vice President and Chief Financial Officer at Advanced Micro Devices Inc., a semiconductor company, from October 2009 to August 2012, and served as Interim Chief Executive Officer from January 2011 to September 2012. From October 2008 to August 2009, Mr. Seifert served as Chief Operating Officer and Chief Financial Officer of Qimonda AG, a German memory chip manufacturer, and as Chief Operating Officer

from June 2004 to October 2008. He also held executive positions at Infineon AG, White Oak Semiconductor, including the position as Chief Executive Officer, and Altis Semiconductor. Mr. Seifert has a Bachelor's degree and a Master's degree in Business Administration from Friedrich Alexander University and a Master's degree in Mathematics and Economics from Wayne State University.

Key Attributes, Experience and Skills

Mr. Seifert has extensive experience as both an operating executive and chief financial officer of large publicly-held international technology businesses, such as Symantec and Advanced Micro Devices. In these and other senior

positions, he developed deep financial and accounting knowledge, as well as managerial leadership skills, in larger organizations. With his background in accounting, finance and management, Mr. Seifert brings broad skills and knowledge to the Board and the Audit Committee, including internal controls, mergers and acquisitions and integrations.

Director Independence

Seven of ten current directors are independent. A predominantly independent Board ensures that the Board is acting objectively and in the best interests of our stockholders. The independent directors also bring expertise and a diversity of perspectives to the Board. The culture of the Board enables directors to openly express their opinions in the boardroom and to raise challenges. The NASDAQ listing standards governing independence require that a majority of the members of the Board be independent as defined by NASDAQ. The Board conducted its annual review of director independence in April 2015. During this review, the Board examined all direct and indirect transactions or relationships between the Company or any of its subsidiaries and each director and any immediate family member of the director and determined that no material relationships with the Company existed during 2014. On the basis of this review, the Board determined that each of the following directors qualifies as an independent director as defined in the NASDAQ guidelines and SEC rules: Robert A. Blair, Michael C. Child, Henry E. Gauthier, William S. Hurley, Eric Meurice, John R. Peeler, and Thomas J. Seifert.

The Board is comprised of directors with short and long-term tenure with the Company. This tenure coupled with an independent and objective Board has provided stockholders with strong financial results.

Standing Committees and Board Committee Membership

The Board has a standing Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee, each composed entirely of non-employee directors determined to be independent under the listing standards of the NASDAQ stock market. Under their written charters adopted by the Board, each of these committees is authorized and assured appropriate funding to retain and consult with external advisors, consultants and counsel. The table below sets forth the directors who are currently members or chairs of each of the standing Board committees, and the number of meetings held by each committee and the full Board in 2014. All incumbent directors attended 75% or more of the aggregate meetings of the Board and committees on which they served during 2014. We encourage directors to attend the annual meeting of stockholders, but we do not have a formal policy regarding such attendance. Last year, five of the directors in office attended the annual meeting.

	Board of Directors	Audit	Compensation	Nominating and Corporate Governance
Meetings held in 2014	8	8	11	8
Written consents in 2014	1	—	1	1
Valentin P. Gapontsev, Ph.D.	Chair			
Robert A. Blair	Member		Member	Chair
Michael C. Child	Member	Member		Member
Henry E. Gauthier	Member, and Presiding Independent Director	Member		
William S. Hurley	Member	Chair	Member	
Eric Meurice	Member			Member
John R. Peeler	Member		Chair	Member
Igor Samartsev	Member			
Eugene Scherbakov, Ph.D.	Member			
Thomas J. Seifert	Member	Member		

The Audit Committee assists the Board by providing oversight of financial management, the internal auditor function and the independent auditor and providing oversight with respect to our internal controls including that management is maintaining an adequate system of internal control such that there is reasonable assurance that

assets are safeguarded and that financial reports are properly prepared; that there is consistent application of generally accepted accounting principles; and that there is compliance with management's financial reporting policies and procedures. The Audit Committee also pre-approves auditing and permissible non-audit services by our independent auditor, reviews and discusses our annual and quarterly financial statements and related disclosures, and coordinates the oversight of our internal and external controls over financial reporting, disclosure controls and procedures and code of business conduct. In performing these functions, the Audit Committee meets periodically with the independent auditor, management and internal auditor function (including in private sessions) to review their work and confirm that they are properly discharging their respective responsibilities. In addition, the Audit Committee appoints the independent auditor. A copy of the charter of the Audit Committee is available on our website at http://investor.ipgphotonics.com/documents.cfm. For more information on Audit Committee activities in 2014, see the Audit Committee Report on page 61 of this proxy statement and Proposal 3: Non-Binding Advisory Vote to Ratify Independent Registered Public Accounting Form.

The Board has determined that Mr. Hurley, the Chairman of the Audit Committee, as well as each of Messrs. Gauthier and Seifert, qualify as an audit committee financial expert (as defined under the rules and regulations of the SEC) after determining that each has the necessary experience and qualifications.

The primary function of the Compensation Committee is to discharge the Board's duties and responsibilities relating to compensation of our non-employee directors and executive officers, and oversee the design and management of the long-term incentive and savings plans that cover our employees. The Compensation Committee's duties and responsibilities under its charter with respect to the compensation of our directors and executive officers include:

- reviewing and approving the Chairman and Chief Executive Officer's base salary compensation;
- determining the annual performance bonus of the Chairman and Chief Executive Officer based upon the corporate goals and objectives set by the independent directors and their input on the attainment of such goals and objectives;
- reviewing and approving compensation decisions recommended by the Chairman and Chief Executive Officer for the other executive officers, including setting base salaries, annual performance bonuses, long-term incentive awards, severance benefits and perquisites;
- setting our compensation philosophy and composition of the group of peer companies used for comparison of executive compensation; and
- reviewing, and recommending for approval by the Board, the compensation for the non-employee directors.

The Compensation Committee has retained an independent compensation consultant firm, Radford, a unit of Aon Hewitt ("Radford"), for matters related to executive officer and director compensation. The Compensation Committee also retains outside legal counsel to provide advice on compensation-related matters, including executive officers, directors and compensation plans. For further discussion of the role of the Compensation Committee in the executive compensation decision-making process and activities in 2014, and for a description of the nature and scope of the consultant's assignment, see "Compensation Discussion and Analysis - Role of Compensation Committee" on page 38 of this proxy statement. Additionally, the Compensation Committee reviews the Compensation Discussion and Analysis, prepares the Compensation Committee Report in this proxy statement on page 29 and oversees management's risk assessment of the Company's compensation for all employees and compensation-related risks as delegated by the Board. A copy of the charter of the Compensation Committee can be found on our website at http://investor.ipgphotonics.com/documents.cfm.

The Nominating and Corporate Governance Committee is responsible for overseeing matters of corporate governance, including the evaluation of the performance and practices of the Board. The Nominating and Corporate Governance Committee develops and recommends criteria for Board membership (see "Corporate Governance - Corporate

Governance Guidelines---Nomination of Directors" for a description of such criteria), reviews possible candidates for the Board, as discussed on page 12 of this proxy statement, and recommends the nominees for directors to the Board for approval. In addition, the Nominating and Corporate Governance Committee oversees the process for annual performance evaluations of the committees of the Board. It is also within the responsibilities of the Nominating and Corporate Governance Committee to review and recommend director orientation, stock ownership guidelines, delegation of authority to management, insider trading guidelines, and consider questions of possible conflicts of interest, including related party transactions, as such questions arise. The Nominating and Corporate Governance Committee also reviews and recommends risk oversight responsibilities of the Board and its committees. A copy of the charter of the Nominating and Corporate Governance Committee can be found on our website at http://investor.ipgphotonics.com/documents.cfm.

Compensation Committee Interlocks and Insider Participation

No member of our Compensation Committee (Messrs. Peeler, Blair and Hurley) is or has been an officer or employee of our Company or any of our subsidiaries. None of our executive officers served as a member of:

- the compensation committee of another entity in which one of the executive officers of such entity served on our Compensation Committee;
- the board of directors of another entity, one of whose executive officers served on our Compensation Committee; or
- the compensation committee of another entity in which one of the executive officers of such entity served as a member of our Board.

DIRECTOR COMPENSATION

The objectives for our non-employee director compensation program are to attract highly-qualified individuals to serve on our Board and align their interests with those of our stockholders. Our non-employee directors are paid pursuant to our non-employee director compensation plan described below. Our Compensation Committee reviews our director compensation program periodically to confirm that the program remains appropriate and competitive and recommends any changes to our full Board for consideration and approval.

Director Compensation Plan

Our non-employee director compensation plan provides for both cash and equity compensation for our non-employee directors. Directors who are also our employees receive no additional compensation for their service as directors. The Compensation Committee engaged Radford, an independent compensation consultant firm, to provide a comprehensive review of compensation for non-employee directors and to make recommendations with regard to director compensation matters.

Cash Compensation. Our non-employee directors receive the annual retainers from us set forth in the table below. Directors do not receive separate fees for attending Board or committee meetings or meetings of stockholders.

	Amount
Board Retainer	$40,000
Presiding Independent Director Retainer	$20,000
Audit Committee Retainers	
Chair	$25,000
Non-Chair	$12,500
Compensation Committee Retainers	
Chair	$22,500
Non-Chair	$10,000
Nominating and Corporate Governance Committee Retainers	
Chair	$17,500
Non-Chair	$7,500

Equity Compensation. Non-employee directors continuing in office after the annual meeting of stockholders receive a grant of stock options to purchase 6,500 shares of common stock and restricted stock units for 1,100 shares of common stock vesting in a single installment on the earlier of the one-year anniversary of the date of grant or the next annual meeting of stockholders. Upon initial election to the Board, each new non-employee director receives a dollar value grant (determined pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 718) of $250,000 in stock options and $250,000 in restricted stock units vesting 25% on the first four anniversaries of the date of grant. The exercise price of each of the stock options is the closing market price of our common stock on the date of grant. Any director who retires after at least eight years of service on the Board will be entitled to full vesting of all options and restricted stock units then held by such director.

2015 Update. The Board recently approved changes to the compensation of non-employee directors after considering the assessment and advice of Radford which reviewed non-employee compensation of our Board compared with the Company's named peers. Effective at the 2015 annual meeting of stockholders, each continuing non-employee director will receive a dollar value annual grant of equity totaling $250,000. Of this award, one-third will be service-based stock options and two-thirds will be service-based restricted stock units. This will be in lieu of the current annual grant to continuing directors of 6,500 options to purchase common stock and restricted stock units for 1,100 shares of common stock. Vesting does not change.

Director Compensation Table

The following table summarizes the compensation of each of our non-employee directors for in 2014:

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)(1)	Option Awards ($)(1)	Total ($)
Robert A. Blair	66,666	69,740	174,135	310,541
Michael C. Child	60,833	69,740	174,135	304,708
Henry E. Gauthier	71,667	69,740	174,135	315,542
William S. Hurley	73,333	69,740	174,135	317,208
Eric Meurice	22,167	251,001	252,442	525,610
John R. Peeler	64,167	69,740	174,135	308,042
Thomas J Seifert	35,000	251,001	252,442	538,443

(1) Valuation based on the fair value of the restricted stock unit and stock option awards as of the grant date determined pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 718 ("ASC Topic 718") with respect to 2014. The assumptions that we used with respect to the valuation of restricted stock unit and stock option awards are set forth in Note 2 to our Consolidated Financial Statements in our Annual Report on Form 10-K filed with the SEC on March 2, 2015. On June 3, 2014, each continuing director serving on the Board was granted restricted stock units for 1,100 shares of common stock and options to purchase 6,500 shares of common stock at an exercise price of $63.40 per share. Both restricted stock units and options vest in a single installment on June 2, 2015. Messrs. Meurice and Seifert, newly elected directors, were granted on June 3, 2014 restricted stock units for 3,959 shares of common stock and options to purchase 9,423 shares of common stock at an exercise price of $63.40 per share. Both restricted stock units and options vest in four annual equal installments commencing on June 3, 2015.

Outstanding Equity Awards Table

The following table provides information regarding unexercised stock options and unvested restricted stock units held by each of our non-employee directors on December 31, 2014:

Name	Unvested Restricted Stock Units (#)	Total Option Awards Held (#)	Exercisable Option Awards (#)
Robert A. Blair	1,100	19,667	13,167
Michael C. Child	1,100	59,669	43,168
Henry E. Gauthier	1,100	46,252	39,752
William S. Hurley	1,100	46,335	39,835
Eric Meurice	3,959	9,423	—
John R. Peeler	1,100	38,000	19,000
Thomas J. Seifert	3,959	9,423	—

We also reimburse directors for all reasonable out-of-pocket expenses incurred for attending Board and committee meetings and director education programs. Non-employee directors do not receive any additional payments or perquisites.

Our certificate of incorporation limits the dollar amount of personal liability of our directors for breaches by them of their fiduciary duties. Our certificate of incorporation requires us to indemnify our directors to the fullest extent permitted by the Delaware General Corporation Law. We have also entered into indemnification agreements with all of our directors and we have purchased directors' and officers' liability insurance.

PROPOSAL 1: ELECTION OF DIRECTORS

The stockholders are being asked to elect Dr. Gapontsev, Dr. Scherbakov, Mr. Samartsev, Mr. Child, Mr. Gauthier, Mr. Hurley, Mr. Meurice, Mr. Peeler and Mr. Seifert to terms ending with the annual meeting to be held in 2016, until a successor is elected and qualified or until his earlier death, resignation or removal. The Board nominated each of these individuals for election at the 2015 annual meeting of stockholders upon the recommendation of the Nominating and Corporate Governance Committee. Each nominee is currently a director of our company. For more information regarding the nominees for director, see "Board of Directors." Mr. Robert Blair decided to not stand for re-election to our Board of Directors at our 2015 annual meeting. The number of directors will be reduced to nine directors from and after the 2015 annual meeting.

The Board does not contemplate that any of the nominees will be unable to stand for election, but should any nominee become unable to serve or for good cause will not serve, all proxies (except proxies marked to the contrary) will be voted for the election of a substitute nominee nominated by the Board.

OUR BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" ALL OF THE NOMINEES FOR DIRECTOR

COMMON STOCK OWNERSHIP

The following table provides information about the beneficial ownership of our common stock as of April 1, 2015 by:

- each person or entity known by us to own beneficially more than five percent of our common stock;
- each of the Named Executive Officers;
- each person who is a director or nominee; and
- all of our executive officers and directors as a group.

In accordance with SEC rules, beneficial ownership includes any shares for which a person or entity has sole or shared voting power or investment power and any shares for which the person or entity has the right to acquire beneficial ownership within 60 days after April 1, 2015 through the exercise of any option, warrant or otherwise. Percentage of beneficial ownership is based on 52,611,235 shares of common stock outstanding as of April 1, 2015, rather than based on the percentages set forth in stockholders' Schedules 13G or 13D, as applicable, filed with the SEC. The contact address of all persons and entities in the table below is in care of IPG Photonics Corporation, 50 Old Webster Road, Oxford, Massachusetts 01540.

Name	Shares Owned	Right to Acquire Shares within 60 Days	Total	Percent	
The Valentin Gapontsev Trust I (1)	14,776,003	—	14,776,003	28.1	%
Valentin P. Gapontsev, Ph.D. (2)	7,379,935	—	7,379,935	14.0	%
IP Fibre Devices (UK) Ltd.	7,064,004	—	7,064,004	13.4	%
Robert A. Blair	22,638	13,167	35,805	*%	
Michael C. Child	10,012	43,168	53,180	*%	
Henry E. Gauthier	14,650	29,752	44,402	*%	
William S. Hurley	10,101	26,501	36,602	*%	
Eric Meurice	—	—	—	*%	
John R. Peeler	1,100	20,563	21,663	*%	
Igor Samartsev (3)(4)(5)	891,514	37,725	929,239	1.8	%
Eugene Scherbakov, Ph.D. (3)(6)	16,690,626	28,062	16,718,688	31.8	%
Thomas J. Seifert	—	—	—	*%	
Angelo P. Lopresti (6)	16,731,029	13,375	16,744,404	31.8	%
Timothy P.V. Mammen	14,277	46,650	60,927	*%	
Alexander Ovtchinnikov, Ph.D. (6)	16,750,331	4,750	16,755,081	31.8	%
Trevor D. Ness	1,500	10,000	11,500	*%	
Nikolai Platonov, Ph.D. (3)(6)	15,719,366	6,750	15,726,116	29.9	%
Felix Stukalin	1,875	7,938	9,813	*%	
All executive officers and directors as a group (15 persons)	18,073,941	288,401	18,362,342	34.7	%

* Less than 1.0%

(1) Includes 7,064,004 shares beneficially owned by IP Fibre Devices (UK) Ltd. ("IPFD"), in which the Valentin Gapontsev Trust I, a trust formed by Dr. Gapontsev (the "Gapontsev Trust I"), has a 48% economic interest. The trustees of the Gapontsev Trust I are Drs. Ovtchinnikov, Platonov and Scherbakov and Mr. Lopresti.

(2) Includes 7,064,004 shares beneficially owned by IPFD, of which Dr. Gapontsev is the sole managing director. Dr. Gapontsev has sole voting and investment power with respect to the shares held of record by IPFD. Dr. Gapontsev has a 3% economic interest in IPFD.

(3) Each such person has an 8% economic interest in IPFD but does not possess voting or investment power with respect to such interest. Each disclaims beneficial ownership of the shares held by IPFD except to the extent of his economic interest therein.

(4) Does not include shares held by IPFD.

(5) Includes 550,000 shares held by a trust of which Mr. Samartsev's wife is the sole trustee. Mr. Samartsev disclaims beneficial ownership of the shares held in such trust.

(6) Includes (a) 14,786,003 shares beneficially owned by the Gapontsev Trust I (see note 1 above), (b) 943,000 shares beneficially owned by the Valentin Gapontsev Trust II, a trust formed by Dr. Gapontsev (the

"Gapontsev Trust II"), and (c) 972,000 shares beneficially owned by the Valentin Gapontsev Trust III, a trust formed by Dr. Gapontsev (the "Gapontsev Trust III"), of each of which Drs. Ovtchinnikov and Scherbakov and Mr. Lopresti is a trustee. Dr. Platonov is a trustee of the Gapontsev Trust I and the Gapontsev Trust II and his beneficial ownership excludes shares beneficially owned by the Gapontsev Trust III. The Gapontsev Trust III has a 2% economic interest in IPFD.

EXECUTIVE OFFICERS

The following table sets forth certain information regarding our executive officers as of April 1, 2015.

Name	Age	Position
Valentin P. Gapontsev, Ph.D.	76	Chief Executive Officer and Chairman of the Board
Eugene Scherbakov, Ph.D.	67	Managing Director of IPG Laser GmbH, Senior Vice President, Europe and Director
Timothy P.V. Mammen	45	Chief Financial Officer and Senior Vice President
Angelo P. Lopresti	51	General Counsel, Secretary and Senior Vice President
Alexander Ovtchinnikov, Ph.D.	54	Senior Vice President, Components
Trevor D. Ness	42	Senior Vice President, World Wide Sales
Igor Samartsev	52	Chief Technology Officer and Director
Felix Stukalin	53	Senior Vice President, U.S. Operations

The biographies of Dr. Gapontsev, Dr. Scherbakov and Mr. Samartsev are presented on page 16. The biographies of our other executive officers are presented below.

Timothy P.V. Mammen has served as our Chief Financial Officer since July 2000 and a Vice President since November 2000. He was promoted to Senior Vice President in February 2013. Between May 1999 and July 2000, Mr. Mammen served as the Group Finance Director and General Manager of the United Kingdom operations for IPFD. Mr. Mammen was Finance Director and General Manager of United Partners Plc, a commodities trading firm, from 1995 to 1999 and prior to that he worked in the finance department of E.I. du Pont de Nemours and Company. Mr. Mammen holds an Upper Second B.Sc. Honours degree in International Trade and Development from the London School of Economics and Political Science. Also, he is a Chartered Accountant and a member of the Institute of Chartered Accountants of Scotland.

Angelo P. Lopresti has served as our General Counsel and Secretary and one of our Vice Presidents since February 2001. He was promoted to Senior Vice President in February 2013. Prior to joining us, Mr. Lopresti was a partner at the law firm of Winston & Strawn LLP from 1999 to 2001. Prior to that, he was a partner at the law firm of Hertzog, Calamari & Gleason from 1998 to 1999 and an associate there from 1991 to 1998. Mr. Lopresti holds a B.A. in Economics from Trinity College and a J.D. from the New York University School of Law.

Alexander Ovtchinnikov, Ph.D., has served as our Vice President, Components, since September 2005 and as Director of Material Sciences from October 2001 to September 2005. He was promoted to Senior Vice President in February 2013. Prior to joining us, Dr. Ovtchinnikov was Material Science Manager of Lasertel, Inc., a maker of high-power semiconductor lasers, from 1999 to 2001. For 15 years prior to joining Lasertel, Inc., he worked on the development and commercialization of high power diode pump technology at the Ioffe Institute, Tampere University of Technology, Coherent, Inc. and Spectra-Physics Corporation. He holds an M.S. in Electrical Engineering from the Electrotechnical University of St. Petersburg, Russia, and a Ph.D. from Ioffe Institute of the Russian Academy of Sciences.

Trevor D. Ness has served as our Senior Vice President, World Wide Sales and Marketing since February 2013. From January 2011 until February 2013, he served as our Vice President-Asian Operations. Prior to joining us, Mr. Ness was Director of GSI Precision Technologies China from May 2005 to December 2010 and prior to that he held technical sales management roles with GSI Group, Inc. and Cobham Plc, located in UK, Japan and Taiwan. Mr. Ness holds a B.S. in Geology from Imperial College, a H.N.C. from Bournemouth University and an M.B.A. from The Open University.

Felix Stukalin has served as our Senior Vice President, U.S. Operations since February 2013. From March 2009 until February 2013, he served as our Vice President, Devices. Prior to joining us, he was Vice President, Business Development of GSI Group Inc. from April 2002 to September 2008, and from March 2000 to April 2002 he was Vice President of Components and President of the Wave Precision divisions of GSI Lumonics, Mr. Stukalin holds a B.S. in Mechanical Engineering from the University of Rochester and he is a graduate of the Harvard Business School General Management Program.

COMPENSATION COMMITTEE REPORT

The Compensation Committee of the Board of Directors has reviewed and discussed with management the Compensation Discussion and Analysis included in this proxy statement. Based on this review and discussion, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Company's proxy statement for the Company's 2015 annual meeting of stockholders and in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

The information in this Compensation Committee Report shall not be considered to be "soliciting material" or be "filed" with the SEC, nor shall this information be incorporated by reference into any previous or future filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company incorporated it by specific reference.

COMPENSATION COMMITTEE
John R. Peeler, Chair
Robert A. Blair
William S. Hurley
March 30, 2015

COMPENSATION DISCUSSION AND ANALYSIS

This Compensation Discussion and Analysis provides a review of our executive compensation philosophy and program, and Compensation Committee decisions for fiscal year 2014. The discussion in this section focuses on the compensation of our "Named Executive Officers" or "NEOs" for fiscal year 2014, who were:

- Valentin P. Gapontsev, Ph.D., our Chairman and Chief Executive Officer;
- Timothy P.V. Mammen, our Senior Vice President and Chief Financial Officer;
- Eugene Scherbakov, Ph.D., the Managing Director of IPG Laser GmbH, our subsidiary, and Senior Vice President, Europe;
- Alexander Ovtchinnikov, Ph.D., our Senior Vice President, Components; and
- Angelo P. Lopresti, our Senior Vice President, General Counsel and Secretary.

2014 Business Summary

We are committed to increasing penetration of fiber lasers into existing industrial laser applications and capitalizing on growing demand for fiber lasers in non-laser applications in a manner that generates future value for our stockholders. IPG continued its revenue and income growth in 2014, finishing another record year, while we continued to make investments for the future. In 2014, we:

- grew sales 19%, exceeding our 2013 grow;th rate of 15%;
- expand our penetration into laser cutting;
- experienced an increase in average powers of high power lasers sold to OEMS;
- continued to gain market share from gas lasers and other types of solid state lasers; and
- introduced new products, systems and accessories.

IPG recorded $769.8 million in revenues in 2014, which is the highest level of revenues for any fiscal year in our history.

Our operating income also achieved its highest levels to date, reaching $284 million in 2014 compared to $218 million in 2013 and $209 million in 2012.

Our gross margin increased to 54.1% in 2014 from 52.5% in 2013, as a result of increased absorption of overhead offset by increasing depreciation from increased investment in plant and equipment. IPG's gross margins are industry-leading as compared to our laser peers.

The Company also increased its cash and cash equivalents to over $522 million at December 31, 2014, compared to $449 million at December 31, 2013, while the Company invested over $90 million in property, plant, equipment and technology so that we are well-positioned for future demand growth for our industry-leading products.

For more information about our business, please read "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K filed with the SEC on March 2, 2015.

Summary of Executive Compensation Pay Practices

The guiding principles of our executive compensation philosophy and practice continue to be pay-for-performance, accountability for short- and long-term performance, alignment to stockholders' interests, and providing competitive pay to attract and retain executives. We believe our compensation program strikes the appropriate balance between utilizing responsible, measured pay practices and effectively incentivizing our executives to dedicate themselves fully to value creation for our stockholders.

Below, we summarize certain executive compensation practices, both the practices we have implemented to drive performance and the practices we have not implemented because we do not believe that they would serve our stockholders' long-term interests practices:

What We Do	What We Don't Do
Align our Officer Pay with Performance: Compensation is tied to Company performance and stockholder returns. The recent addition of performance stock units that are earned based upon IPG's total stockholder return increases the portion of NEO compensation tied to performance.	No Retirement Benefits: We have no supplemental executive retirement plans (SERPs) or defined benefit pension plans.
Balance Short-Term and Long-Term Incentives: Incentive programs provide an appropriate balance of annual and long-term incentives and include multiple measures of performance.	No Tax Gross-Ups: We do not provide tax gross reimbursements for change in control payments or executive perquisites, which are minimal.
Use Long-Term Incentives to Link Executive Pay to Company Performance: 44% of NEO pay consists of long-term incentives linked to increasing our stock price.	Hedging of Company Stock is Prohibited. We have Limits on Pledging
Cap Incentive Awards: Short-term incentive plan awards and certain long-term incentives plan awards are capped.	No Severance For "Cause" Terminations
Maximize Stockholder Value While Mitigating Risk: Our equity incentives drive performance and reward growth over the long-term, which discourages short-term risk taking. We have four-year cliff vesting for annual equity awards.	No Single-Trigger Change in Control Provisions
Have Stringent Stock Ownership Requirements: NEOs substantially exceed our ownership guidelines.	No Stock Option Repricing without Stockholder Approval
Impose Clawbacks on Executive Compensation: We have a newly-adopted compensation recovery policy.	No Dividends on Unvested RSUs and PSUs

Say-On-Pay

At our 2014 annual meeting of stockholders, our stockholders overwhelmingly approved our executive compensation structure in a "say-on-pay" advisory vote, voting 99 percent in favor of our executive compensation structure compared to less than 1 percent against. Because a substantial majority of our stockholders approved the compensation program described in our 2014 proxy statement, the Compensation Committee did not implement changes to our executive compensation program as a direct result of the stockholders' advisory vote. At our stockholders meeting in 2011, the advisory proposal to hold "say-on-pay" advisory votes every three years received the greatest amount of votes and, therefore, we elected to submit the advisory "say-on-pay" proposal to our stockholders on a triennial basis. Accordingly, the next "say on pay" advisory vote is being held at our 2017 annual meeting of stockholders.

Executive Compensation Design

Our executive compensation program is designed to focus executive officers on both short-term and long-term financial and operational performance, without encouraging unnecessary risk. The following graphs show approximately 52 percent of the Chief Executive Officer's total direct compensation, and approximately 68 percent of the average total direct compensation of all of the other Named Executive Officers compensation, as reflected in the 2014 column of the Summary Compensation Table, is at risk.

Our Chief Executive Officer, the Company's founder, does not receive long-term incentives because of his significant level of common stock ownership. As a result, a smaller percentage of his total compensation is performance-based as compared to the chief executives of our peer companies, who receive additional compensation in the form of long-term incentives.

The following provides details on the components of our executive compensation program:

Compensation Element	Objective
Base salary	• Provide a competitive fixed component of cash compensation to attract and retain talented and experienced executives with the knowledge and skills necessary to achieve the Company's strategic business objectives. • The Compensation Committee uses the services of an independent compensation consultant to assess the base salaries as compared to a competitive target range of the Company's named peer group. • The Compensation Committee considers these when setting base salaries of the executive officers: scope of the executive's responsibilities, performance, contributions, skills and experience, annual and long-term Company performance.
Short-term incentive plan	• Offer a variable cash compensation opportunity earned based upon the level of achievement of challenging corporate goals, with additional compensation opportunity based upon individual performance. • Foster a shared commitment among executives through establishment of uniform Company financial goals. • Award payouts are subject to a cap of 225% of target in a performance period.
Long-term incentives	• Align interests of our executives and stockholders by motivating executive officers to increase long-term stockholder value. • Service-based equity awards offer certainty and long-term retention while providing additional compensation opportunity based upon increased stock price levels. • Beginning in 2015, performance stock units provide an additional incentive to our NEOs and will be earned based on IPG's total stockholder return relative to the Russell 3000 index. • Strengthen retention with four-year vesting provisions.
401(k) Retirement Savings Plan	• Provides participants the opportunity to defer a portion of their compensation and receive a company match of 50% of deferrals subject to a maximum of 6% of eligible compensation. • The plan is available to all eligible U.S. employees of the Company.
Pension Plan	• We provide no pension plan or deferred compensation plan.
Perquisites	• There are no perquisites, with the exception of one Company vehicle available to one executive for personal and business use.

Base Salary

We provide base salary to our Named Executive Officers and other employees to compensate them for services rendered on a day-to-day basis during the fiscal year. Unlike short-term cash incentives and long-term equity incentives, base salary is not subject to performance risk. The Compensation Committee reviews information provided by its compensation consultant and considers the experience, skills, knowledge and responsibilities of the executive and the individual's performance assessment provided by the Chief Executive Officer to assist it in evaluating base salary for each Named Executive Officer. With respect to the Chief Executive Officer, the Compensation Committee additionally considers the performance of the Company as a whole.

In 2014, the Compensation Committee reviewed the base salaries and total cash compensation for the Named Executive Officers with the assistance of Radford. The Compensation Committee reviewed and discussed the Radford

assessment in connection with positioning the midpoint of the Company's target total cash compensation range near the 65th percentile of our peer group. Based upon this, the Compensation Committee approved increases of 3% to the base salaries of the Named Executive Officers, except for Mr. Mammen who received an increase in base salary of 5% bringing his base salary in line with the market 65th percentile of our peer group. Despite strong Company financial performance and a base salary substantially below the market 50th percentile, the Compensation Committee approved only a 3% increase in 2014 for the Chief Executive Officer.

Update 2015. Following an assessment of base salaries and total cash compensation with the analysis of Radford, the Compensation Committee approved merit increases in 2015 of 3% to the base salaries of the Named Executive Officers from 2014 levels, except that the CEO's base salary was increased 18.5% to $662,500, bringing his base salary to approximately the market 50th percentile. In addition, the salary of Dr. Scherbakov was increased from approximately $449,100 to $462,200 bringing his base salary to the target market 65th percentile.

2014 Cash Incentive Awards

To focus each executive officer on the importance of the Company performance, a significant portion of the individual's potential short-term compensation is in the form of annual cash incentive pay that is tied to the achievement of goals established by the Compensation Committee. Our Named Executive Officers participate in our Senior Executive Short-Term Incentive Plan (the "STIP") administered by the Compensation Committee. The Compensation Committee determines who is eligible to receive awards under the STIP, establishes performance goals and objectives for executives, establishes target awards for each participant for the relevant performance period, and determines the percentage of the target award that should be allocated to the achievement of each of the chosen performance goals in consultation with the Chief Executive Officer with respect to other executive officers. The target award percentages established by the Compensation Committee are chosen with input from the compensation assessment conducted by Radford and the seniority level of the executive.

Consistent with prior years, the Compensation Committee in 2014 identified two financial performance measures: net sales and adjusted EBIT (excluding equity-based compensation expenses and expenses for approved litigation matters), each as determined under the STIP, and assigned a 50% weighting factor to each financial performance goal. The Compensation Committee chose to focus on revenue growth and pretax profits so that our executive officers would be incentivized to deliver the types of growth that benefit our stockholders, namely increasing sales and profits. Under the 2014 STIP, the executives could receive cash incentive payments in the table below as a percentage of base salaries based upon achievement of the minimum to maximum objectives for both financial performance measures and for individual performance. If the financial performance exceeds one or more of the maximum objectives, the incentive payments to the executive would increase as determined by linear interpolation, subject to limits on award payouts. Consistent with our pay-for-performance philosophy, no cash incentive payments would be made if the minimum financial objectives established by the Compensation Committee in 2014 were not met. The individual goals and objectives for the Chief Executive Officer include additional operational and strategic targets determined by the independent directors.

The overall target awards in the table below are a percentage of the respective base salaries. The company-wide financial objectives are the same for all executive officers in order to foster a shared commitment among executives.

Name	Target	Financial Performance Minimum	Financial Performance Maximum	Individual Performance Maximum	Maximum Award Payout	Target Award ($)(1)	Actual Payout ($)
Valentin P. Gapontsev, Ph.D.	100%	18.8%	112.5%	25%	225%	559,084	609,780
Timothy P.V. Mammen	67%	12.5%	75%	16.7%	225%	274,298	299,158
Eugene Scherbakov, Ph.D.	67%	12.5%	75%	16.7%	225%	296,924	244,042
Alexander Ovtchinnikov, Ph.D.	67%	12.5%	75%	16.7%	225%	249,684	272,314
Angelo P. Lopresti	67%	12.5%	75%	16.7%	225%	256,812	280,088

(1) Target Awards include both financial and individual performance targets.

While objectives were intended to be achievable by the Company, a maximum bonus would require very high levels of Company performance. The Compensation Committee set minimum and maximum targets for net sales of $640 million and $866 million, respectively, representing a change ranging from a decrease of 1%

to an increase of 34% from the prior year. The minimum and maximum targets for adjusted EBIT were set from $221 million to $331 million, representing a change ranging from a decrease of 4% to an increase of 43% from the prior year. The target levels for net sales and adjusted EBIT were $732 million and $276 million, respectively.
The Company's record financial performance for 2014 exceeded financial performance targets set by the Compensation Committee. The Company achieved net sales of $770 million and adjusted EBIT of $294 million. These results represented a 19% increase in net sales and a 27% increase in adjusted EBIT over 2013 levels. The independent directors set the individual goals and objectives for the Chief Executive Officer in 2014. The Compensation Committee reviewed the Chief Executive Officer's attainment then (with input from the independent directors) early in 2015 and awarded him 25.0% of his base salary for his individual performance during 2014. Also, the Compensation Committee, with input from the Chief Executive Officer, awarded the other Named Executive Officers 16.7% of their respective base salaries for their individual performances in 2014.
The Compensation Committee may in its discretion award discretionary bonuses for exceptional performance of an executive. For 2014, the Committee exercised this discretion and awarded Dr. Scherbakov a discretionary bonus of €11,185 for his outstanding leadership and performance in 2014.

2015 Update. Following a recent review of incentive compensation practices at peer companies, market practices and target total cash compensation, the Committee in 2015 increased the size of overall target awards for Dr. Scherbakov and Mr. Mammen to 75% of base salary.
Equity-Based Incentives Granted in 2014
The goal of our equity-based award program is to provide employees and executives with the perspective of an owner with a long-term financial stake in our success, further increasing alignment with stockholders. Our equity-based incentive align the interests of our executives and stockholders by motivating executive officers to increase long-term stockholder value.
Our equity-based award program in 2014 was based on annual grants of service-based stock options and restricted stock units: 75% was in the form of stock options and 25% was in the form of restricted stock units. Consistent with our pay-for-performance philosophy, the service-based stock option awards have no value unless our stock price increases after the grant date. Another reason why we use service-based stock options is because it fosters an innovative environment focused on long-term growth of the Company and stockholder value. The value of stock options and restricted stock units are solely tied to the Company stock price which correlates to stockholder interests.
In 2014, the Compensation Committee targeted granting equity compensation near the 50th percentile of the target compensation of our peer group, balancing the perspective of delivering competitive compensation based upon Black-Scholes option pricing values. The Compensation Committee analyzed several aspects of the equity grant program, including (i) the "in the money" value, the degree to which executives have incentives to remain employed by the Company through unvested option values, and (ii) the aggregate equity usage in terms of (a) annual usage, typically called burn rate, and (b) cumulative equity delivery, typically called overhang, to determine the dilutive effect of equity awards on investors. The majority of outstanding equity holdings of the executives (other than Dr. Gapontsev) were allocated to unvested shares in the aggregate, and all such executives had a minimum of four years' worth of annual award values in unvested equity value. Based upon this information, Radford advised the Compensation Committee that our equity program provides strong retention incentives.
The table below provided information on grants of service-based stock options and restricted stock units to the Named Executive Officers in 2014:

Equity-Based Incentives Granted in 2014

Name	Service-Based Stock Options (#)	Exercise Price ($)	Service-Based Restricted Stock Units (#)	Vesting Date
Valentin P. Gapontsev, Ph.D.	—	—	—	
Timothy P.V. Mammen	14,200	71.77	2,200	March 1, 2018
Eugene Scherbakov, Ph.D.	13,000	71.77	2,000	March 1, 2018
Alexander Ovtchinnikov, Ph.D.	12,000	71.11	1,900	March 1, 2018
Angelo P. Lopresti	11,000	71.77	1,800	March 1, 2018

The Compensation Committee believes that four-year vesting provides a strong incentive for executives to remain employed by us and to focus on increasing our financial performance over the long-term, while discouraging short-term risk taking. The RSUs granted in 2014 are not entitled to dividends, should any be paid.

Since the Company's initial public offering in 2006, the Compensation Committee has not granted the Chief Executive Officer any equity compensation awards. As the Company's founder and the beneficial owner of a large number of our shares, he has the perspective of an owner with a significant financial stake in the Company's success. This practice has resulted in substantially lower total compensation earned by our Chief Executive Officer as compared to the chief executives of our named peers despite our outstanding business and earnings growth and lower equity burn rate for the Company.

2015 Update. Following a recent review of grant practices at peer companies and market practices, the Compensation Committee approved changes to the mix of long-term equity incentives for executives. For 2015 equity-based awards, 33% each are in the forms of service-based stock options, service-based restricted stock units, and a new equity vehicle in our award program, performance-based stock units ("PSUs"). With respect to the PSUs, the Compensation Committee decided to measure performance of the Company's stock as compared to the Russell 3000 Index, of which the Company is a member. The addition of PSUs to the equity mix increases the portion of the executives' compensation that is based upon the Company's performance. Also, it directly aligns executives' compensation with stockholder interest because the number of shares earned depends upon performance against the Russell 3000 Index and the value of the shares fluctuates based on the stock price. For each 1% that IPG's common stock exceeds the performance of the Russell 3000 Index for the trailing 60 trading days from the end of the performance measurement period (March 1, 2018) against the comparable period from the beginning of the performance measurement period (March 1, 2015), the grant recipient would receive a 2% increase in the number of shares above target (up to a maximum cap of 200% of the target award). For each 1% below the Russell 3000 Index's performance, the grant recipient would receive a 2% decrease in the number of shares (down to zero). The vesting date is March 1, 2019, should any PSUs vest at all. Dividends, if any, on shares underlying the PSUs do not vest until the PSUs vest .

All Other Compensation

Severance Benefits. The severance benefits we offer assist us in recruiting and retaining talented individuals and are consistent with the range of severance benefits offered by our peer group. The severance provisions of our employment agreements are summarized below in the section titled "Potential Payments upon Termination or Change in Control."

Retirement Benefits. We do not offer an executive retirement plan or a non-qualified deferred compensation plan. Executive officers in the United States are eligible to participate in our 401(k) retirement plan on the same terms as all other U.S. employees. Our 401(k) retirement plan is a tax-qualified plan and therefore is subject to certain Internal Revenue Code limitations on the dollar amounts of deferrals and Company contributions that can be made to plan accounts. These limitations apply to our more highly-compensated employees (including the Named Executive Officers). We made matching contributions to our employees at a rate of 50% of deferrals subject to a maximum of 6% of eligible compensation under the 401(k) retirement plan, including the Named Executive Officers, who participate in the plan as set forth in the Summary Compensation Table. Our matching contributions are subject to a limit. Our executives outside of the United States participate in government-sponsored retirement programs.

Personal Benefits. Our executives are eligible to participate in employee benefit plans, including medical, dental, life and disability insurance, vacation and employee stock purchase plans. These plans generally are available to all salaried employees and do not discriminate in favor of executive officers. Benefits are intended to be competitive with the overall market in order to facilitate attraction and retention of high-quality employees. The Compensation Committee reviews executive perquisites in comparison to the peer group and made no changes in 2014. The Company provides Dr. Scherbakov with the use of an automobile, as it does to other high-ranking employees in Germany. The Company provides the use a corporate aircraft to the Chief Executive Officer and other executives for business travel integral to the performance of their duties. Executives are encouraged to use the aircraft for efficiency, safety and security. However, executives are not allowed to use the aircraft for unreimbursed personal use.

Role of Compensation Committee

The Compensation Committee determines, approves and administers the compensation programs for our executive officers, including our Named Executive Officers. Our Compensation Committee is also responsible for making recommendations to the Board with respect to the adoption of equity plans and certain other benefit plans. The Compensation Committee may delegate authority whenever it deems appropriate, but it did not do so in 2014.

Our Compensation Committee's policy is to set executive officer pay in accordance with the objectives of the Company's compensation programs as described above. In the Compensation Committee's view, the Company's executive compensation program provides an overall level of compensation opportunity that is competitive with peer companies. Actual compensation levels may be greater or less than target compensation levels provided by similar companies based upon short-term and long-term Company performance, as well as individual performance, contributions, skills, seniority, knowledge, experience and responsibilities.

Role of Management

The Chief Executive Officer participates in the establishment of the compensation targets and payout levels for the other Named Executive Officers. He assesses the performance for all Named Executive Officers and recommends to the Compensation Committee the overall levels of achievement, and personal performance in the year. Upon request, Named Executive Officers will provide supplemental material to the Compensation Committee to assist in making its determinations and the establishment of policies and practices. The Chief Executive Officer is not involved in any part of the setting of any component of his compensation. The Chief Executive Officer and other members of senior management attend Compensation Committee meetings at the invitation of the Compensation Committee.

Role of Independent Consultant

The Compensation Committee engaged Radford, an independent compensation consultant, to conduct a comprehensive review and analysis of our executive compensation program and to make recommendations for compensation related to 2014. Other than providing non-executive compensation data and valuation services for equity incentives, neither Radford nor Radford's parent company does any other work for the Company. The Compensation Committee reviews the independence of Radford in light of SEC rules and NASDAQ listing standards regarding compensation consultants. The Compensation Committee believes that there are no actual or potential conflicts of interest with Radford in 2014.

Pay Positioning Strategy

In 2014, we positioned the midpoint of the Company's target total cash compensation range near the 65th percentile and the long-term incentive range near the 50th percentile of the target compensation of our peer group, resulting in targeted total compensation that is competitive within our labor market. An individual's actual compensation may fall below or above the target positions based on the individual's experience, seniority, skills, knowledge, performance and contributions as well as the Company's performance. These factors are weighed by the Compensation Committee in its judgment, and no single factor takes precedence over others nor is any formula used in making these decisions.

In analyzing our executive compensation program relative to this target market positioning, the Compensation Committee utilizes a comparative analysis of the compensation of our executive officers measured against a group of peer companies selected by the Compensation Committee. The peer companies are companies in the laser source and photonics industry, as well as a broader group of technology companies of comparable size and complexity that have similar growth rates and international scopes. For 2014, the peer companies were:

- II-VI Incorporated
- Analogic Corporation
- Brooks Automation, Inc.
- Chart Industries, Inc.
- Cognex Corporation
- Coherent, Inc.
- Diodes, Inc.
- Entegris, Inc.
- FEI Company
- FLIR Systems, Inc.
- Graco, Inc.
- Hittite Microwave Corporation
- MKS Instruments, Inc.
- Newport Corporation
- RBC Bearings, Inc.
- Rofin-Sinar Technologies Inc.
- Riverbed Technology, Inc.
- Teradyne, Inc.
- Veeco Instruments Inc.

The Compensation Committee reviews this peer group annually to ensure that the comparisons are meaningful. In this review, the Compensation Committee conducted an analysis of our peers to determine which companies are frequently referenced and whether they should be considered for inclusion in IPG Photonics' peer group, as well as which companies are no longer publicly traded. Based upon this review and applying the criteria above, the Compensation Committee removed Cymer Inc. from the peer group for 2014 and Hittite Microwave Corporation from the peer group for 2015 because each was acquired in the prior year.

Radford also supplements its peer analysis with the data from a broader list of high-technology public company participants in the Radford Executive Technology Survey targeting technology companies with comparable revenue levels.

Other Factors Affecting Compensation

Tax Deductibility under Section 162(m). Section 162(m) of the Internal Revenue Code ("Section 162(m)"), limits the deductibility for federal income tax purposes of certain compensation paid in any year by a publicly held corporation to its chief executive officer and its three other most highly compensated officers other than its chief financial officer to $1 million per executive (the "$1 million cap"). The $1 million cap does not apply to "performance-based" compensation as defined under Section 162(m). The Compensation Committee's policy with respect to Section 162(m) is to consider the tax deductibility of awards as a factor in the compensation setting process while providing our executive officers with appropriate rewards for their performance. The Compensation Committee retains the discretion to provide compensation that may exceed the $1 million cap or not qualify for the performance-based compensation exception to Section 162(m).

Accounting Considerations. We consider the accounting implications of all aspects of its executive compensation program. In addition, accounting treatment is just one of many factors impacting plan design and pay determinations. Our executive compensation program is designed to attempt to achieve a favorable accounting and tax treatment possible as long as doing so does not conflict with intended plan design or program objectives.

Compensation Risk

Management conducts an annual risk assessment of the Company's compensation policies and practices for all employees, including non-executive officers, and reports its findings to the Compensation Committee. In 2014, management concluded that the Company's compensation policies and practices are balanced and do not motivate imprudent risk taking. The Company's compensation programs reward consistent, long-term performance by heavily weighting compensation to long-term incentives that reward sustainable financial and operating performance and imposing lengthy vesting schedules. The Company's annual incentive compensation is based on performance measures that promote progress towards longer-term goals and is capped at sustainable levels. The Company believes that it has appropriate procedures in place to mitigate material risks, if any, from its compensation practices and policies.

The Compensation Committee does not believe that our compensation policies and practices for our employees give rise to risks that are reasonably likely to have a material adverse effect on our Company. In reaching this conclusion, they considered the following factors:

- our compensation program is designed to provide a mix of both fixed and variable incentive compensation;
- our senior executives are subject to stock ownership guidelines, which we believe incentivize our executives to consider the long-term interests of the Company and our stockholders and discourage excessive risk-taking that could negatively impact our stock price; and
- our incentive compensation programs are designed with vesting terms that are relatively consistent, spread out over several years, and do not contain steep payout "cliffs" that might encourage short-term business decisions in order to meet a vesting or payout threshold.

Other Policies

Anti-Hedging and Limitations on Pledging of Company Stock. The Board adopted policies prohibiting hedging transactions and limiting the pledging of our common stock. Under our insider trading policy, no director or employee may engage in shorting shares of our common stock, or buying or selling puts, calls or derivatives related to our common stock. A director or officer of the Company may not pledge shares constituting more than 20% of his or her total stock ownership. Pledges of shares constituting 20% or less of total stock ownership are subject to certain conditions.

Stock Ownership Guidelines. The Board adopted stock ownership guidelines to closely align the interests of our executive officers with those of our long-term stockholders. Under the guidelines, the Chief Executive Officer is expected to maintain a minimum investment on our common stock of five times his annual salary and other senior executive officers are expected to maintain a minimum investment on our common stock of the lesser of 5,000 shares or one times their respective annual salaries. All of our senior executive officers substantially exceed the ownership requirements under our stock ownership guidelines. These ownership levels are to be achieved no later than four years after the election as an executive officer, except that prior to such time the officer is expected to retain a certain portion of stock issued upon exercise of stock options or vesting of restricted stock awards until the minimum ownership levels are attained. For more information, see "Corporate Governance - Stock Ownership Guidelines."

Clawback Policies. In March 2015, the Compensation Committee approved a compensation recovery policy that allows the Company to recapture performance-based compensation from executives if the amount of the award was based upon achieving certain financial results that were later restated due to the participant's misconduct. In addition, all equity awarded to employees since 2007 contain a provision under which employees may be required to forfeit equity awards or profit from equity awards if they engage in certain conduct, including competing against the Company, disclosing confidential information, or soliciting its employees or customers.

EXECUTIVE COMPENSATION TABLES

Summary Compensation Table

The following table provides information regarding compensation earned by our Chief Executive Officer, our Chief Financial Officer and our three other most highly compensated executives for the fiscal years indicated below:

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(1)	Option Awards ($)(1)	Non-Equity Incentive Plan Compensation ($)(2)	All Other Compensation ($)(3)	Total ($)
Valentin P. Gapontsev, Ph.D.,	2014	559,259	—	—	—	609,780	11,125	1,180,164
Chief Executive	2013	542,800	—	—	—	455,894	11,125	1,009,819
Officer and Chairman of the Board(4)	2012	475,822	—	—	—	369,850	12,345	858,017
Timothy P.V. Mammen,	2014	411,426	—	157,894	469,026	299,158	8,610	1,346,114
Chief Financial	2013	391,834	—	150,275	432,302	219,402	8,190	1,202,003
Officer and Senior Vice President	2012	340,101	901	255	2,565	816		
Total Compensation and Benefits Expense	$	7,375	$ 6,232	$ 22,026	$ 18,255			

For the three and nine months ended September 30, 2010 and 2009, the Company granted no options to purchase capital units of the operating company and no options to purchase shares of Class A common stock pursuant to its 2006 Plan and 2007 Plan.

For the nine months ended September 30, 2010 and 2009, the operating company granted 7,000 and 30,000, respectively, restricted Class B units to certain members pursuant to its 2006 Plan. These unit grants each vest ratably over a four-year period commencing January 1, 2010 and 2009, respectively. The amortization of these awards was not material for the three and nine months

Table of Contents

Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

ended September 30, 2010 and 2009. For the three months ended September 30, 2010 and 2009, no such options were granted.

Pursuant to the Pzena Investment Management, LLC Amended and Restated Bonus Plan (the Bonus Plan), which became effective January 1, 2007, eligible employees whose cash compensation is in excess of certain thresholds have a portion of that excess mandatorily deferred. Amounts deferred may take the form of phantom Class B units, or be invested in third-party funds at the employee s discretion, and vest ratably over four years. At both September 30, 2010 and December 31, 2009, the liability associated with deferred compensation investment accounts was approximately $0.6 million, and has been included as a component of other liabilities on the consolidated statements of financial condition. For the three months ended September 30, 2010 and 2009, the Company recognized approximately $0.4 million and $0.3 million, respectively, in compensation and benefits expense associated with the amortization of all deferred compensation awards. For the nine months ended September 30, 2010 and 2009, the Company recognized approximately $0.9 million and $0.6 million, respectively, in such expense.

As of September 30, 2010 and December 31, 2009, the Company had approximately $3.4 million and $5.3 million, respectively, in unrecorded compensation expense related to unvested operating company phantom units issued pursuant to our deferred compensation plan, operating company Class B unit and option grants issued under the Company s 2006 Plan, and Class A stock option grants issued under our 2007 Plan.

Note 7 Short Term Borrowings

The operating company had a $1.8 million revolving credit facility that was terminated in September 2009. No balance was outstanding and no amounts were drawn down against the facility over the course of its existence.

Note 8 Term Loan

During the year ended December 31, 2009, the Company repaid the remaining $22.0 million of the principal amount outstanding under its term loan. Concurrently with the termination of this term loan, the security interest previously granted in the accounts receivable of the Company was released in September 2009.

Note 9 Interest Rate Swap

The Company manages its exposure to changes in market rates of interest. The Company s use of derivative instruments was limited to an interest rate swap used to manage the interest rate exposure related to the credit agreement, referenced above, which was terminated in

September 2009.

On February 28, 2008, the Company entered into an interest rate swap agreement that commenced on July 23, 2008. This interest rate swap was subsequently unwound in conjunction with the termination of the credit agreement in September 2009. The swap obligated the Company to pay a 2.825% fixed rate of interest on the notional amount and required the counterparty to pay the Company a floating interest rate based on the monthly LIBOR interest rate. The spread on the credit agreement was in addition to these amounts.

During 2009, the Company reduced the notional amount of its interest rate swap in tandem with the reductions in principal amounts outstanding under the credit agreement. The amounts paid to the counterparty in exchange for these reductions for the three and nine months ended September 30, 2009 were approximately $0.2 million and $0.5 million, respectively. For each of the three and nine months ended September 30, 2009, the Company recognized less than $0.1 million in other expense associated with the change in fair value of the swap agreement.

Note 10 Income Taxes

The operating company is a limited liability company that has elected to be treated as a partnership for tax purposes. Neither it, nor the Company s other consolidated subsidiaries, has made a provision for federal or state income taxes because it is the individual responsibility of each of these entities members (including the Company) to separately report their proportionate share of the respective entity s taxable income or loss. The operating company has made a provision for New York City UBT. Subsequent to the offering and reorganization on October 30, 2007, the Company, as a C corporation under the Internal Revenue Code, is liable for federal, state, and local taxes on the income derived from its economic interest in its operating company, which is net of UBT. Correspondingly, in its consolidated financial statements, the Company reports both the operating company s provision for UBT, as well as its provision for federal, state, and local corporate taxes.

Table of Contents

Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

The components of the income tax provision/(benefit) are as follows:

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
	(in thousands)			
Current Provision:				
Unincorporated Business Taxes	$ 602	$ 572	$ 1,951	$ 1,426
Local Corporate Tax				
State Corporate Tax				
Federal Corporate Tax				
Total Current Provision	$ 602	$ 572	$ 1,951	$ 1,426
Deferred Provision:				
Unincorporated Business Taxes	$ (56)	$ (56)	$ (168)	$ (167)
Local Corporate Tax	60	57	176	121
State Corporate Tax	114	108	335	231
Federal Corporate Tax	391	372	1,152	793
Total Deferred Provision	$ 509	$ 481	$ 1,495	$ 978
Change in Valuation Allowance	(2,186)	(3,093)	(2,073)	(4,783)
Total Income Tax Provision/(Benefit)	$ (1,075)	$ (2,040)	$ 1,373	$ (2,379)

For the three and nine months ended September 30, 2010 and 2009, the Company s taxable income was determined as follows:

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
	(in thousands)			
Income Before Taxes	$ 8,177	$ 10,228	$ 27,681	$ 21,888
Unincorporated Business Taxes	(546)	(516)	(1,783)	(1,259)
Non-Controlling Interests	(8,033)	(10,836)	(23,632)	(21,531)
Income Before Corporate Income Taxes	$ (402)	$ (1,124)	$ 2,266	$ (902)

The *Income Taxes Topic* of the FASB ASC establishes the minimum threshold for recognizing, and a system for measuring, the benefits of tax return positions in financial statements. It is the Company s policy to recognize accrued interest, and penalties associated with uncertain tax positions, as part of the tax provision. For the three and nine months ended September 30, 2010 and 2009, no such expenses were recognized. As of September 30, 2010 and December 31, 2009, no such accruals were recorded.

The Company and the operating company are generally no longer subject to U.S. Federal or state and local income tax examinations by tax authorities for any year prior to 2007. All tax years subsequent to, and including, 2007 are considered open and subject to examination by tax authorities.

Prior to October 30, 2007, the operating company was a cash basis taxpayer. As a result of the Company s acquisition of Class B units in conjunction with the offering, the operating company was required to become an accrual basis taxpayer. Pursuant to Section 481 of the Internal Revenue Code, the cumulative difference between the two methods of taxpaying are amortizable over four years. These differences generated approximately $0.1 million and $0.2 million in deferred tax liabilities as of September 30, 2010 and December 31, 2009, respectively. Such amounts are recorded in other liabilities in the consolidated statements of financial condition.

Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

The acquisition of the operating company Class B units noted above has allowed the Company to make an election under Section 754 of the Internal Revenue Code (Section 754) to step up its tax basis in the net assets acquired. This step up is deductible for tax purposes over a 15-year period. Pursuant to a Tax Receivable Agreement signed between the members of the operating company and the Company, 85% of the cash savings generated by this election will be distributed to the selling and converting shareholders upon the realization of this benefit.

Based on the net proceeds of the offering and tax basis of the operating company as of October 30, 2007, this election gave rise to a deferred tax asset of approximately $68.7 million. In December 2008, the Company established a $62.7 million valuation allowance to reduce the net deferred tax asset to an amount more likely than not to be realized. This deferred tax asset remains available to the Company and can be used to reduce taxable income in future years. The Company similarly reduced the associated liability to selling and converting shareholders to reflect this change in the estimated realization of the asset.

As discussed further in Note 14, Shareholders Equity, below, on March 31, 2010, and March 3, 2009, certain of the operating company s members exchanged an aggregate of 734,618 and 2,445,973, respectively, of their Class B units for an equivalent number of shares of Company Class A common stock. The Company elected to step up its tax basis in the incremental assets acquired in accordance with Section 754. Based on the exchange-date fair values of the Company s common stock and the tax basis of the operating company, this election gave rise to a $3.6 million deferred tax asset and a corresponding $3.0 million liability to converting shareholders on March 31, 2010, and a $2.5 million deferred tax asset and a corresponding $2.2 million liability to converting shareholders on March 3, 2009. The Company assessed the realizability of the deferred tax asset associated with each of these exchanges and determined that a portion of their benefits would go unutilized. Consequently, at March 31, 2010 and March 3, 2009, the Company established valuation allowances of $3.2 million and $2.4 million, respectively, to reduce the deferred tax asset to, an amount more likely than not to be realized, at each date. These deferred tax assets remain available to the Company and can be used to reduce taxable income in future years. The Company similarly reduced the associated liability to selling and converting shareholders by $2.7 million and $2.0 million at March 31, 2010 and March 3, 2009, respectively, to reflect this change in the estimated realization of the asset. As required by the *Income Taxes Topic* of the FASB ASC, the Company recorded the effects of these transactions in equity.

During the three months ended September 30, 2010 and 2009, the Company reduced its valuation allowance by approximately $2.2 million and $3.1 million, respectively, due to revised estimates of future taxable income. To reflect this change in the estimated realization of the asset, the Company correspondingly increased its liability to selling and converting shareholders by $1.7 million and $2.4 million for the three months ended September 30, 2010 and 2009, respectively. During the nine months ended September 30, 2010 and 2009, including the effects of the conversion discussed earlier, the Company s valuation allowance was reduced by approximately $2.1 million and $4.8 million, respectively, due to revised estimates of future taxable income. To reflect this change in the estimated realization of the asset, the Company correspondingly increased its liability to selling and converting shareholders by $1.6 million and $3.6 million for the nine months ended September 30, 2010 and 2009, respectively. The effects of these changes to the deferred tax asset and liability to selling and converting shareholders were recorded as a component of the income tax provision and other expense, respectively, on the consolidated statements of operations. As of September 30, 2010 and December 31, 2009, the net values of all deferred tax assets were approximately $7.6 million and $6.8 million, respectively.

As of September 30, 2010 and December 31, 2009, the net value of the liability to selling and converting shareholders was approximately $7.6 million and $5.6 million, respectively.

The change in the Company s net deferred tax assets for the three and nine months ended September 30, 2010 is summarized as follows:

Table of Contents

Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

	Section 754	Other	Valuation Allowance	Total
		(in thousands)		
Balance at December 31, 2009	$ 65,006	$ 2,001	$ (60,253)	$ 6,754
Deferred Tax Expense	(726)	173		(553)
Unit Conversion	3,577		(3,186)	391
Change in Valuation Allowance			1,266	1,266
Balance at March 31, 2010	$ 67,857	$ 2,174	$ (62,173)	$ 7,858
Deferred Tax Expense	(849)	303		(546)
Change in Valuation Allowance			(1,379)	(1,379)
Balance at June 30, 2010	$ 67,008	$ 2,477	$ (63,552)	$ 5,933
Deferred Tax Expense	(801)	236		(565)
Change in Valuation Allowance			2,186	2,186
Balance at September 30, 2010	$ 66,207	$ 2,713	$ (61,366)	$ 7,554

The change in the Company s net deferred tax assets for the three and nine months ended September 30, 2009 is summarized as follows:

	Section 754	Other	Valuation Allowance	Total
		(in thousands)		
Balance at December 31, 2008	$ 65,368	$ 785	$ (62,709)	$ 3,444
Deferred Tax Expense	(714)	512		(202)
Unit Conversion	2,532		(2,380)	152
Change in Valuation Allowance			814	814
Balance at March 31, 2009	$ 67,186	$ 1,297	$ (64,275)	$ 4,208
Deferred Tax Expense	(726)	320		(406)
Change in Valuation Allowance			876	876
Balance at June 30, 2009	$ 66,460	$ 1,617	$ (63,399)	$ 4,678
Deferred Tax Expense	(727)	190		(537)
Change in Valuation Allowance			3,093	3,093
Balance at September 30, 2009	$ 65,733	$ 1,807	$ (60,306)	$ 7,234

Note 11 Investments, at Fair Value

Investments consisted of the following at September 30, 2010:

Cost	Unrealized Gain	Fair Value
	(in thousands)	

Investments	$ 2,777	$ 281	$ 3,058

Investments consisted of the following at December 31, 2009:

	Cost	Unrealized Gain (in thousands)	Fair Value
Investments	$ 7,321	$ 630	$ 7,951

Table of Contents

Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

Note 12 Non-Controlling Interests

Non-controlling interests in the operations of the Company s operating company and consolidated subsidiaries are comprised of the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Non-Controlling Interest of Pzena Investment Management, LLC	$ 7,722	8,082	$ 23,483	17,767
Non-Controlling Interest of Consolidated Subsidiaries	311	2,754	149	3,764
Non-Controlling Interests	$ 8,033	$ 10,836	$ 23,632	$ 21,531

Note 13 Members Equity Interests of Operating Company

Except as otherwise provided by law, the liability of a member of the operating company is limited to the amount of its capital account. A member may transfer or assign all or any part of its membership interest with the prior written consent of Pzena Investment Management, Inc., which may be withheld at its sole discretion. Any transferee admitted as a member shall succeed to the capital account, or portion thereof, transferred or assigned, as if no such transfer or assignment had occurred.

Note 14 Shareholders Equity

The Company was incorporated in the State of Delaware on May 8, 2007. On October 30, 2007, the Company consummated an initial public offering of shares of its Class A common stock, par value $0.01 per share. These net proceeds were used to purchase Class B units of the operating company. Concurrently with the consummation of the Company s initial public offering, the operating agreement of the operating company was amended and restated such that, among other things, (i) the Company became the sole managing member of the operating company, (ii) the Class B units of the operating company that the Company acquired were reclassified as Class A units of the operating company, and (iii) the holders of the remaining outstanding Class B units of the operating company were reclassified as Class B units of the operating company. Class A and Class B units of the operating company have the same economic rights per unit. As of September 30, 2010, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 14.6% and 85.4%, respectively, of the economic interests in the operations of the business. As of December 31, 2009, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 13.4% and 86.6%, respectively, of the economic interests in the operations of the business.

Each holder of a Class B unit of the operating company is issued a corresponding share of the Company s Class B common stock, par value $0.000001 per share, in exchange for payment of this par value. Each share of the Company s Class B common stock entitles its holder to five votes, until the first time that the number of shares of Class B common stock outstanding constitutes less than 20% of the number of all shares of the Company s common stock outstanding. From this time and thereafter, each share of the Company s Class B common stock entitles its holder to one vote. When a Class B unit is exchanged for a share of the Company s Class A common stock or forfeited, a corresponding share of the Company s Class B common stock will automatically be redeemed and cancelled. Conversely, to the extent that the Company causes the operating company to issue additional Class B units to employees pursuant to its equity incentive plan, these additional holders of Class B units would be entitled to receive a corresponding number of shares of the Company s Class B common stock (including if the Class B units awarded are subject to vesting).

All holders of the Company s Class B common stock have entered into a stockholders agreement, pursuant to which they agreed to vote all shares of Class B common stock then held by them, and acquired in the future, together on all matters submitted to a vote of the common stockholders.

The outstanding shares of the Company s Class A common stock represent 100% of the rights of the holders of all classes of the Company s capital stock to receive distributions, except that holders of Class B common stock will have the right to receive the class s par value upon the Company s liquidation, dissolution or winding up.

Pursuant to the operating agreement of the operating company, each vested Class B unit is exchangeable for a share of the Company s Class A common stock, subject to certain exchange timing and volume limitations.

Table of Contents

Pzena Investment Management, Inc.

Unaudited Notes to the Consolidated Financial Statements (Continued)

On March 31, 2010, and March 3, 2009, certain of the operating company s members exchanged an aggregate of 734,618 and 2,445,973, respectively, of their Class B units for an equivalent number of shares of Company Class A common stock. These acquisitions of additional operating company membership interests were treated as reorganizations of entities under common control as required by the *Business Combinations Topic* of the FASB ASC.

The incremental assets and liabilities assumed in the exchanges were recorded on March 31, 2010 and March 3, 2009 as follows:

	March 31, 2010	March 3, 2009
	(in thousands)	
Pzena Investment Management, LLC Members Capital	$ 10,140	$ 33,788
Pzena Investment Management, LLC Accumulated Deficit	(9,824)	(33,679)
Realizable Deferred Tax Asset	391	152
Net Tax Receivable Liability to Converting Unitholders	(332)	(129)
Total	$ 375	$ 132
Common Stock, at Par	$ 7	$ 25
Additional Paid-in Capital	368	107
Total	$ 375	$ 132

Note 15 Subsequent Events

As required by the *Subsequent Events Topic* of the FASB ASC, the Company evaluated subsequent events through the issuance date of its consolidated financial statements.

On October 26, 2010, the Company s Board of Directors declared a quarterly dividend of $0.03 per share of Class A common stock, payable on December 2, 2010 to shareholders of record as of November 18, 2010.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

We are an investment management firm that utilizes a classic value investment approach in each of our investment strategies. We currently manage assets in a variety of value-oriented investment strategies across a wide range of market capitalizations in both U.S. and non-U.S. capital markets. At September 30, 2010, our assets under management, or AUM, was $14.3 billion. We manage separate accounts on behalf of institutions and high net worth individuals and act as a sub-investment adviser for a variety of SEC-registered mutual funds and offshore funds.

We function as the holding company through which the business of our operating company, Pzena Investment Management, LLC, is conducted. Following our initial public offering and reorganization on October 30, 2007, we became the sole managing member of Pzena Investment Management, LLC. As such, we now control its business and affairs and, therefore, consolidate its financial results with ours. In light of our employees and other investors collective membership interest in our operating company, we reflect their ownership as a non-controlling interest in our consolidated financial statements. As a result, subsequent to October 30, 2007, our income is generated by our economic interest in our operating company s net income. As of September 30, 2010, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 14.6% and 85.4%, respectively, of the economic interests in the operations of the business.

Revenue

We generate revenue primarily from management fees and incentive fees, which we collectively refer to as our advisory fees, by managing assets on behalf of institutional accounts and for retail clients, which are generally open-end mutual funds catering primarily to retail clients. Our advisory fee income is recognized over the period in which investment management services are provided. Following the preferred method identified in the *Revenue Recognition Topic* of the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC), income from incentive fees is recorded at the conclusion of the contractual performance period, when all contingencies are resolved.

Our advisory fees are primarily driven by the level of our AUM. Our AUM increases or decreases with the net inflows or outflows of funds into our various investment strategies and with the investment performance thereof. In order to increase our AUM and expand our business, we must develop and market investment strategies that suit the investment needs of our target clients and provide attractive returns over the long term. The value and composition of our AUM, and our ability to continue to attract clients, will depend on a variety of factors including, among other things:

- our ability to educate our target clients about our classic value investment strategies and provide them with exceptional client service;
- the relative investment performance of our investment strategies, as compared to competing products and market indices;

- competitive conditions in the investment management and broader financial services sectors;
- general economic conditions;
- investor sentiment and confidence; and
- our decision to close strategies when we deem it to be in the best interests of our clients.

For our institutional accounts, we are paid fees according to a schedule, which varies by investment strategy. The substantial majority of these accounts pay us management fees pursuant to a schedule in which the rate we earn on the AUM declines as the amount of AUM increases. Certain of these clients pay us fees according to the performance of their accounts relative to certain agreed-upon benchmarks, which results in a slightly lower base fee, but allows us to earn higher fees if the relevant investment strategy outperforms the agreed-upon benchmark.

Pursuant to our sub-investment advisory agreements with our retail clients, we are generally paid a management fee according to a schedule in which the rate we earn on the AUM declines as the amount of AUM increases. Certain of these funds pay us fixed rate management fees. Due to the substantially larger account size of certain of these accounts, the average advisory fees we earn on them, as a percentage of AUM, are lower than the advisory fees we earn on our institutional accounts.

Table of Contents

The majority of advisory fees we earn on institutional accounts are based on the value of AUM at a specific date on a quarterly basis, either in arrears or advance. Generally, advisory fees on certain of our institutional accounts, and with respect to most of our retail accounts, are calculated based on the average of the monthly or daily market values. Advisory fees are generally adjusted for any cash flows into or out of a portfolio, where the cash flow represents greater than 10% of the value of the portfolio. While a specific group of accounts may use the same fee rate, the method used to calculate the fee according to the fee rate schedule may differ as described above.

Our advisory fees may fluctuate based on a number of factors, including the following:

- changes in AUM due to appreciation or depreciation of our investment portfolios, and the levels of the contribution and withdrawal of assets by new and existing clients;
- distribution of AUM among our investment strategies, which have different fee schedules;
- distribution of AUM between institutional accounts and retail accounts, for which we generally earn lower overall advisory fees; and
- the level of our performance with respect to accounts on which we are paid incentive fees.

Expenses

Our expenses consist primarily of compensation and benefits expenses, as well as general and administrative expenses. These expenses may fluctuate due to a number of factors, including the following:

- variations in the level of total compensation expense due to, among other things, bonuses, awards of equity to our employees and members of our operating company, changes in our employee count and mix, and competitive factors; and
- expenses, such as rent, professional service fees and data-related costs, incurred, as necessary, to run our business.

Compensation and Benefits Expense

Our largest expense is compensation and benefits, which includes the salaries, bonuses, equity-based compensation and related benefits and payroll costs attributable to our members and employees. Compensation and benefits packages are benchmarked against relevant industry and geographic peer groups in order to attract and retain qualified personnel. The table included in the section below describes the components of our compensation expense for the three and nine months ended September 30, 2010 and 2009:

	For the Three Months Ended September 30,		**For the Nine Months Ended September 30,**	
	2010	**2009**	**2010**	**2009**
	(in thousands)			
Cash Compensation and Other Benefits	$ 6,474	$ 5,977	$ 19,461	$ 17,439
Other Non-Cash Compensation	901	255	2,565	816
Total Compensation and Benefits Expense	$ 7,375	$ 6,232	$ 22,026	$ 18,255

Pursuant to the Pzena Investment Management, LLC 2006 Equity Incentive Plan (the 2006 Plan) and the Pzena Investment Management, Inc. 2007 Equity Incentive Plan (the 2007 Plan, together the 2006 and 2007 Plans), we have issued restricted Class B units and options to acquire Class B units in our operating company, and options to acquire shares of our Class A common stock, all of which vest ratably over the respective award s vesting period. We used a fair-value method in recording the compensation expense associated with the granting of these stock-based compensation awards. Under this method, compensation expense is measured at the grant date based on the estimated fair value of the award and is recognized over the award s vesting period. The fair value of the units is determined by reference to the market price of our Class A common stock on the date of grant, since these units are exchangeable for shares of our Class A common stock on a one-for-one basis. The fair value of the options to acquire Class B units and options to acquire shares of our Class A common stock is determined by using an appropriate option pricing model on the grant date.

Table of Contents

On January 1, 2007, we instituted a deferred compensation plan, in which employees who earn in excess of $600,000 per year are required to defer a portion of their compensation in excess of this amount. These deferred amounts may take the form of phantom Class B units, or be invested in a variety of third-party mutual funds at the employee s discretion, and vest ratably over four years. Amounts deferred in any period reduce that period s cash compensation expense and vest ratably over a four-year period beginning on January 1 of the next year. Should additional amounts be deferred in future periods, we would expect the non-cash portion of our compensation expense to increase as the existing and subsequently deferred amounts are amortized through income.

As of September 30, 2010, we had approximately $3.4 million in unrecorded compensation expense related to unvested operating company phantom units issued pursuant to our deferred compensation plan, operating company Class B unit and option grants issued under our 2006 Plan, and Class A stock and option grants issued under our 2007 Plan. We expect that the amortization of these amounts will be approximately $0.7 million for the remainder of 2010, $2.6 million for 2011, and $0.1 million for 2012, with a negligible amount amortized thereafter.

General and Administrative Expenses

General and administrative expenses include professional and outside services fees, office expenses, depreciation and the costs associated with operating and maintaining our research, trading and portfolio accounting systems. Our occupancy-related costs and professional services expenses, in particular, generally increase or decrease in relative proportion to the overall size and scale of our business operations.

As a result of our offering on October 30, 2007, we have incurred, and expect to continue to incur, additional expenses associated with being a public company for, among other things, director and officer insurance, director fees, SEC reporting and compliance (including Sarbanes-Oxley compliance), professional fees, transfer agent fees, and other similar expenses. These additional expenses have and will continue to reduce our net income.

Other Income/(Expense)

Other income/(expense) is derived primarily from changes in our estimates of the liability due to our selling and converting shareholders associated with payments owed to them under the tax receivable agreement which was executed in connection with our reorganization and offering on October 30, 2007. As discussed further below, under Tax Receivable Agreement, this liability represents 85% of the amount of cash savings, if any, in U.S. federal, state, and local income tax that we realize as a result of the amortization of the increases in tax basis generated from the Company s acquisitions of operating company units from its selling and converting shareholders. Amounts waived by our selling and converting shareholders have, and would, reduce this liability. Other income/(expense) is also affected by the investment income or loss which arose from our investments in various private investment vehicles that we employed to incubate new strategies prior to their redemption during the three months ended September 30, 2010, the non-controlling interest allocation of the income or loss of our consolidated investment partnerships to their outside investors, interest expense on our outstanding debt prior to its extinguishment, mark-to-market movements on our swap agreement prior to its termination, net realized and unrealized gains and losses from our investments in mutual funds, and interest income generated on our excess cash balances. We expect the interest and investment components, if any, of other income/(expense), in the aggregate, to fluctuate based on market conditions.

Non-Controlling Interests

Our operating company has historically consolidated the results of operations of the private investment partnerships over which we exercise a controlling influence. After our reorganization, we became the sole managing member of our operating company and now control its business and affairs and, therefore, consolidate its financial results with ours. In light of our employees and outside investors interest in our operating company, we have reflected their membership interests as a non-controlling interest in our consolidated financial statements. As a result, subsequent to October 30, 2007, our income is generated by our economic interest in our operating company s net income. As of September 30, 2010, the holders of Class A common stock (through the Company) and the holders of Class B units of the operating company held approximately 14.6% and 85.4%, respectively, of the economic interests in the operations of the business.

Income Tax Provision/(Benefit)

While our operating company has historically not been subject to U.S. federal and certain state income taxes, it has been subject to New York City Unincorporated Business Tax. As a result of our reorganization, we are subject to taxes applicable to C-corporations. As such, our effective tax rate has increased as a result of our reorganization. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount more likely than not to be realized. As of September 30, 2010 and December 31, 2009, the Company s valuation allowance against the deferred tax asset associated with our acquisition of operating company units in conjunction with the offering and subsequent exchanges was $61.4 million and $60.3 million, respectively.

Table of Contents

Operating Results

General

Our earnings and cash flows are heavily dependent upon prevailing financial market conditions. Significant increases or decreases in the various securities markets, particularly the equities markets, can have a material impact on our results of operations, financial condition, and cash flows.

Beginning in the second half of 2007 and continuing through the quarter ended March 31, 2009, the performance of our investment strategies was negatively impacted by significant volatility in the equity markets. Performance prior to March 31, 2009 was influenced by our overweight investment exposure to the financial services sector in particular. Subsequent to March 31, 2009, all of our investment strategies experienced improvement in their performance, and outperformed their respective benchmarks. As a result, our assets under management increased by $0.4 billion, or 2.9%, from $13.9 billion at September 30, 2009, to $14.3 billion at September 30, 2010, due to positive performance of $0.9 billion, offset by net outflows of $0.5 billion.

For the three months ended September 30, 2010, we experienced net outflows of $0.3 billion, consisting of gross outflows of $1.2 billion, offset by gross inflows of $0.9 billion. For the nine months ended September 30, 2010, we experienced net outflows of $0.7 billion, consisting of gross outflows of $3.0 billion, offset by gross inflows of $2.3 billion.

For the three months ended September 30, 2010, our institutional accounts experienced gross inflows of $0.6 billion, which were offset by $0.5 billion in gross outflows. For the nine months ended September 30, 2010, our institutional accounts experienced gross inflows of $1.3 billion, which were offset by $1.3 billion in gross outflows.

For the three months ended September 30, 2010, our retail accounts experienced $0.7 billion in gross outflows and $0.3 billion in gross inflows. For the nine months ended September 30, 2010, our retail accounts experienced $1.7 billion in gross outflows and $1.0 billion in gross inflows.

Our average AUM fluctuates based on changes in the market value of accounts advised and managed by us, and on fund flows. Accordingly, given our higher average AUM levels, our revenues for the three and nine months ended September 30, 2010 increased compared to our revenues for the three and nine months ended September 30, 2009. An increase in revenue typically results in higher operating income and net income.

Table of Contents

Assets Under Management and Flows

The change in AUM in our institutional accounts and our retail accounts for the three and nine months ended September 30, 2010 and 2009 and the twelve months ended September 30, 2010 is described below:

Assets Under Management	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009	For the Twelve Months Ended September 30, 2010
			(in billions)		
Institutional Accounts					
Beginning of Period Assets	$10.0	$7.5	$10.7	$7.4	$10.2
Inflows	*0.6*	*0.9*	*1.3*	*1.8*	*2.2*
Outflows	*(0.5)*	*(0.3)*	*(1.3)*	*(1.5)*	*(1.8)*
Net Flows	0.1	0.6	0.0	0.3	0.4
Market Appreciation	1.2	2.1	0.6	2.5	0.7
End of Period Assets	$11.3	$10.2	$11.3	$10.2	$11.3
Retail Accounts					
Beginning of Period Assets	$3.1	$3.1	$3.6	$3.3	$3.7
Inflows	*0.3*	*0.3*	*1.0*	*0.9*	*1.5*
Outflows	*(0.7)*	*(0.4)*	*(1.7)*	*(1.5)*	*(2.4)*
Net Flows	(0.4)	(0.1)	(0.7)	(0.6)	(0.9)
Market Appreciation	0.3	0.7	0.1	1.0	0.2
End of Period Assets	$3.0	$3.7	$3.0	$3.7	$3.0
Total					
Beginning of Period Assets	$13.1	$10.6	$14.3	$10.7	$13.9
Inflows	*0.9*	*1.2*	*2.3*	*2.7*	*3.7*
Outflows	*(1.2)*	*(0.7)*	*(3.0)*	*(3.0)*	*(4.2)*
Net Flows	(0.3)	0.5	(0.7)	(0.3)	(0.5)
Market Appreciation	1.5	2.8	0.7	3.5	0.9
End of Period Assets	$14.3	$13.9	$14.3	$13.9	$14.3

At September 30, 2010, our $14.3 billion of AUM was invested in various value-oriented investment strategies representing distinct geographical segments. The following table describes the allocation of our AUM, as of September 30, 2010 and 2009, among our investment strategies:

Investment Strategy	AUM at September 30, 2010	AUM at September 30, 2009
	(in billions)	
U.S. Value Strategies	$ 9.2	$ 9.9
Global Value Strategies	3.2	2.4
Europe, Australasia, and Far East (EAFE) Value Strategies	1.9	1.6
Total	$ 14.3	$ 13.9

Three Months Ended September 30, 2010 versus September 30, 2009

At September 30, 2010, we managed $14.3 billion in total assets, an increase of $0.4 billion, or 2.9%, from $13.9 billion at September 30, 2009. The year-over-year increase in AUM was primarily due to $0.9 billion in market appreciation and $3.7 million in gross inflows, offset by $4.2 billion in gross outflows. Improving overall economic conditions contributed to the performance-related increase in our AUM.

At September 30, 2010, we managed $11.3 billion in institutional accounts and $3.0 billion in retail accounts, for a total of $14.3 billion in assets. For the three months ended September 30, 2010, assets in institutional accounts increased by $1.3 billion, or 13.0%, due to $1.2 billion in market appreciation and $0.6 billion in gross inflows, offset by $0.5 billion in gross outflows. For the three months ended September 30, 2010, assets in retail accounts decreased by $0.1 billion, or 3.2%, as a result of $0.7 billion in gross outflows, offset by $0.3 billion in gross inflows and $0.3 billion in market appreciation.

Table of Contents

Nine Months Ended September 30, 2010 versus September 30, 2009

At September 30, 2010, we managed $14.3 billion in total assets, an increase of $0.4 billion, or 2.9%, from $13.9 billion at September 30, 2009. The year-over-year increase in AUM was primarily due to $0.9 billion in market appreciation and $3.7 million in gross inflows, offset by $4.2 billion in gross outflows. Improving overall economic conditions contributed to the performance-related increase in our AUM.

At September 30, 2010, we managed $11.3 billion in institutional accounts and $3.0 billion in retail accounts, for a total of $14.3 billion in assets. For the nine months ended September 30, 2010, assets in institutional accounts increased by $0.6 billion, or 5.6%, due to $0.6 billion in market appreciation and $1.3 billion in gross inflows, offset by $1.3 billion in gross outflows. For the nine months ended September 30, 2010, assets in retail accounts decreased by $0.6 billion, or 16.7%, as a result of $1.7 billion in gross outflows, offset by $1.0 billion in gross inflows and $0.1 billion in market appreciation.

At September 30, 2010, institutional accounts represented 79.0% of our total AUM, compared to 73.4% at September 30, 2009. At September 30, 2010, our Global Value and EAFE Value investment strategies accounted for 35.7% of our AUM, compared to 28.8% at September 30, 2009.

Revenues

Our revenues from advisory fees earned on our institutional and retail accounts for the three and nine months ended September 30, 2010 and 2009 is described below:

Revenue	**For the Three Months Ended September 30, 2010**	**For the Three Months Ended September 30, 2009**	**For the Nine Months Ended September 30, 2010**	**For the Nine Months Ended September 30, 2009**
	(in thousands)			
Institutional Accounts	$ 15,491	$ 13,839	$ 47,756	$ 36,466
Retail Accounts	2,991	2,974	9,264	8,251
Total	$ 18,482	$ 16,813	$ 57,020	$ 44,717

Three Months Ended September 30, 2010 versus September 30, 2009

Our total revenue increased $1.7 million, or 10.1%, to $18.5 million for the three months ended September 30, 2010, from $16.8 million for the three months ended September 30, 2009. This change was driven primarily by an increase in weighted average AUM, which increased $1.4 billion, or 11.5%, to $13.6 billion for the three months ended September 30, 2010, from $12.2 billion for the three months ended September 30, 2009.

Our weighted average fee rate was 0.544% and 0.550% for the three months ended September 30, 2010 and 2009, respectively. The decrease in the weighted average fee rate was due in part to large institutional inflows in our newly launched Europe, Australasia, and Far East (EAFE) Diversified Value and Global Diversified Value strategies in the fourth quarter of 2009. We typically offer reduced fee rates to initial clients in our new product offerings. The decrease in the weighted average fee rate was also due to an increase in the average size of our institutional accounts. Our tiered fee schedules typically charge lower rates as account size increases. Weighted average assets in institutional accounts increased $1.7 billion, or 19.3%, to $10.5 billion for the three months ended September 30, 2010, from $8.8 billion for the three months ended September 30, 2009, and had a weighted average fee rate of 0.589% and 0.630% for the three months ended September 30, 2010 and 2009, respectively. This decline was primarily due to institutional inflows in our EAFE Diversified Value and Global Diversified Value strategies, and a higher average institutional account size. Weighted average assets in retail accounts decreased $0.3 billion, or 8.8%, to $3.1 billion for the three months ended September 30, 2010, from $3.4 billion for the three months ended September 30, 2009, and had a weighted average fee rate of 0.389% and 0.346% for the three months ended September 30, 2010 and 2009, respectively. The year-over-year increase was due to the timing of asset flows in our retail accounts and the expiration of the voluntary partial fee waiver on the John Hancock Classic Value Fund, for which we act as sub-investment advisor, which ended in May 2010.

Nine Months Ended September 30, 2010 versus September 30, 2009

Our total revenue increased $12.3 million, or 27.5%, to $57.0 million for the nine months ended September 30, 2010, from $44.7 million for the nine months ended September 30, 2009. This change was driven primarily by an increase in weighted average AUM, which increased $3.5 billion, or 32.7%, to $14.2 billion for the nine months ended September 30, 2010, from $10.7 billion for the nine months ended September 30, 2009.

Table of Contents

Our weighted average fee rate was 0.537% and 0.559% for the nine months ended September 30, 2010 and 2009, respectively. The decrease in the weighted average fee rate was due primarily to an increase in the average size of our institutional accounts. Our tiered fee schedules typically charge lower rates as account size increases. Weighted average assets in institutional accounts increased $3.2 billion, or 42.1%, to $10.8 billion for the nine months ended September 30, 2010, from $7.6 billion for the nine months ended September 30, 2009, and had a weighted average fee rate of 0.590% and 0.642% for the nine months ended September 30, 2010 and 2009, respectively. Weighted average assets in retail accounts increased $0.3 billion, or 9.7%, to $3.4 billion for the nine months ended September 30, 2010, from $3.1 billion for the nine months ended September 30, 2009, and had a weighted average fee rate of 0.367% and 0.355% for the nine months ended September 30, 2010 and 2009, respectively. The year-over-year increase in weighted average fee rate for retail assets was due to the timing of asset flows in our retail accounts and the effects of the voluntary partial fee waiver on the John Hancock Classic Value Fund, for which we act as sub-investment advisor, which commenced in May 2009 and expired in May 2010.

Expenses

Our operating expenses are driven primarily by our compensation costs. The table below describes the components of our compensation expense for the three and nine months ended September 30, 2010 and 2009:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(in thousands)			
Cash Compensation and Other Benefits	$ 6,474	$ 5,977	$ 19,461	$ 17,439
Other Non-Cash Compensation	901	255	2,565	816
Total Compensation and Benefits Expense	$ 7,375	$ 6,232	$ 22,026	$ 18,255

Three Months Ended September 30, 2010 versus September 30, 2009

Total operating expenses increased by $1.1 million, or 13.6%, to $9.2 million for the three months ended September 30, 2010, from $8.1 million for the three months ended September 30, 2009. This increase was primarily attributable to increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010.

Compensation and benefits expense increased by $1.2 million, or 19.4%, to $7.4 million for the three months ended September 30, 2010, from $6.2 million for the three months ended September 30, 2009. This increase was primarily a result of increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010, as discussed above.

General and administrative expenses decreased by $0.1 million, or 5.3%, to $1.8 million for the three months ended September 30, 2010, from $1.9 million for the three months ended September 30, 2009. This decrease was mainly attributable to decreases in insurance fees.

Nine Months Ended September 30, 2010 versus September 30, 2009

Total operating expenses increased by $3.4 million, or 13.8%, to $28.0 million for the nine months ended September 30, 2010, from $24.6 million for the nine months ended September 30, 2009. This increase was primarily attributable to increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010.

Compensation and benefits expense increased by $3.7 million, or 20.2%, to $22.0 million for the nine months ended September 30, 2010, from $18.3 million for the nine months ended September 30, 2009. This increase was primarily a result of increases in discretionary bonus accruals and employee headcount, which increased from 65 at September 30, 2009 to 71 at September 30, 2010, as discussed above.

General and administrative expenses decreased by $0.4 million, or 6.3%, to $5.9 million for the nine months ended September 30, 2010, from $6.3 million for the nine months ended September 30, 2009. This decrease was mainly attributable to decreases in professional fees and insurance fees.

Table of Contents

Other Income/(Expense)

Three Months Ended September 30, 2010 versus September 30, 2009

Other income/(expense) was an expense of $1.1 million for the three months ended September 30, 2010. Exclusive of $1.7 million in other expense associated with a decrease in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax asset, other income/(expense) was income of $0.6 million. This income consisted primarily of $0.5 million in unrealized and realized gains and losses from investments. Net realized and unrealized gain/(loss) from investments represents both the Company s and external investors allocation of the gain/(loss) from the Company s consolidated investments. At September 30, 2010, the Company had total assets of $0.8 million in such investments. Of the net realized and unrealized gain/(loss) from investments for the three months ended September 30, 2010, $0.3 million was attributable to the outside interests of our investment partnerships. The external investors allocation of net realized and unrealized gain/(loss) is also included as a component of net income from non-controlling interests. Interest and dividend income was income of $0.1 million.

Other income/(expense) was income of $1.6 million for the three months ended September 30, 2009. Exclusive of $2.4 million in other expense associated with an increase in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax asset, other income/(expense) was income of $4.0 million. This income consisted primarily of $4.2 million in income related to the positive performance of investments in our own products, offset by $0.2 million in net interest expense. Net realized and unrealized gain/(loss) from investments represents both the Company s and external investors allocation of the gain/(loss) from the Company s consolidated investments. At September 30, 2009, the Company had total assets of $18.4 million in such investments. Of the $4.2 million in income related to the positive performance of our investments in our own products, $2.8 million was attributable to the outside interests of our investment partnerships. The external investors allocation of net realized and unrealized gain/(loss) is also included as a component of net income from non-controlling interests.

Nine Months Ended September 30, 2010 versus September 30, 2009

Other income/(expense) was an expense of $1.4 million for the nine months ended September 30, 2010. Exclusive of $1.6 million in other expense associated with an increase in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax asset, other income/(expense) was income of $0.2 million. This income consisted primarily of $0.1 million in miscellaneous income and $0.1 million in income related to the positive performance of our investments in our own products, all of which was attributable to the outside interests of our investment partnerships. At September 30, 2010, the Company had total assets of $0.8 million in such investments. The external investors allocation of net realized and unrealized gain/(loss) is also included as a component of net income from non-controlling interests.

Other income/(expense) was income of $1.8 million for the nine months ended September 30, 2009. Exclusive of $3.6 million in other expense associated with an increase in our liability to our selling and converting shareholders associated with changes in the realizability of our related deferred tax, other income/(expense) was income of $5.4 million. This income consisted primarily of $6.1 million in income related to the positive performance of our investments in our own products and $0.2 million in miscellaneous income, offset by $0.9 million in net interest expense. Net realized and unrealized gain/(loss) from investments represents both the Company s and external investors allocation of the gain/(loss) from the Company s consolidated investments. At September 30, 2009, the Company had total assets of $18.4 million in such investments. Of the $6.1 million in income related to the positive performance of our investments in our own products, $3.8 million was attributable to the outside interests of our investment partnerships. The external investors allocation of net realized and unrealized gain/(loss) is

also included as a component of net income from non-controlling interests.

Income Tax Provision/(Benefit)

Three Months Ended September 30, 2010 versus September 30, 2009

The income tax provision/(benefit) was a benefit of $1.1 million for the three months ended September 30, 2010. This benefit was generated primarily due to a $2.2 million reduction of the valuation allowance against our deferred tax asset associated with our tax receivable agreement. Exclusive of this adjustment, the remaining income tax provision for the three months ended September 30, 2010 consisted of $0.5 million in operating company unincorporated business taxes and $0.6 million in corporate income taxes. The income tax provision/(benefit) for the three months ended September 30, 2009 was a benefit of $2.0 million and was generated primarily due to a reduction of $3.1 million to the valuation allowance against our deferred tax asset associated with our tax receivable agreement. Exclusive of this adjustment, the remaining income tax provision for the three months ended September 30, 2009 consisted of $0.5 million in operating company unincorporated business taxes and $0.5 million in corporate income taxes. A comparison of the effective tax rate for the three months ended September 30, 2010 to that of the three months ended September 30, 2009 is not meaningful due to the valuation allowance adjustments.

Table of Contents

Nine Months Ended September 30, 2010 versus September 30, 2009

The income tax provision/(benefit) was a provision of $1.4 million for the nine months ended September 30, 2010. Exclusive of a reduction of $2.1 million to the income tax provision related to an increase to the valuation allowance against our deferred tax asset associated with our tax receivable agreement, the remaining income tax provision for the nine months ended September 30, 2010 consisted of $1.8 million in operating company unincorporated business taxes and $1.7 million in corporate income taxes. The income tax provision/(benefit) for the nine months ended September 30, 2009 was a benefit of $2.4 million and was generated primarily due to a reduction of $4.8 million to the valuation allowance against our deferred tax asset associated with our tax receivable agreement. Exclusive of this adjustment, the remaining income tax provision for the nine months ended September 30, 2009 consisted of $1.3 million in operating company unincorporated business taxes and $1.1 million in corporate income taxes. A comparison of the effective tax rate for the nine months ended September 30, 2010 to that of the nine months ended September 30, 2009 is not meaningful due to the valuation allowance adjustments.

Non-Controlling Interests

Three Months Ended September 30, 2010 versus September 30, 2009

Net income attributable to non-controlling interests was $8.0 million for the three months ended September 30, 2010, and consisted of $7.7 million associated with our employees and outside investors interest in the income of the operating company and $0.3 million of income from our consolidated subsidiaries interest in the earnings of our consolidated investment partnerships. Net income attributable to non-controlling interests was $10.8 million for the three months ended September 30, 2009, and consisted of $8.1 million associated with our employees and outside investors interest in the income of the operating company and $2.8 million of income from our consolidated subsidiaries interest in the earnings of our consolidated investment partnerships. The increase in the interest in the earnings of the operating company is primarily a result of the increase in our weighted average AUM, which had a corresponding positive impact on revenues and income. The decrease in our consolidated subsidiaries interest in the earnings of our consolidated investment partnerships is primarily a result of the deconsolidation of the Pzena Global Value Service and the Pzena EAFE Value Service on December 31, 2009, and the deconsolidation of the Pzena Emerging Market Countries Value Service and the Pzena Emerging Markets Focused Value Service during the three months ended September 30, 2010.

Nine Months Ended September 30, 2010 versus September 30, 2009

Net income attributable to non-controlling interests was $23.6 million for the nine months ended September 30, 2010, and consisted of $23.5 million associated with our employees and outside investors interest in the income of the operating company and $0.1 million of income from our consolidated subsidiaries interest in the earnings of our consolidated investment partnerships. Net income attributable to non-controlling interests was $21.5 million for the nine months ended September 30, 2009, and consisted of approximately of $17.7 million associated with our employees and outside investors interest in the income of the operating company and $3.8 million of income from our consolidated subsidiaries interest in the earnings of our consolidated investment partnerships. The increase in the interest in the earnings of the operating company is primarily a result of the increase in our weighted average AUM, which had a corresponding positive impact on revenues and income. The decrease in our consolidated subsidiaries interest in the earnings of our consolidated investment partnerships is primarily a result of the deconsolidation of the Pzena Global Value Service and the Pzena EAFE Value Service on December 31, 2009, and the deconsolidation of the Pzena Emerging Market Countries Value Service and the Pzena Emerging Markets Focused Value Service during the three months ended September 30, 2010.

Non-GAAP Net Income

Our results for the three and nine months ended September 30, 2010 and 2009 included adjustments related to our tax receivable agreement and the associated liability to our selling and converting shareholders. Excluding these adjustments, diluted net income and diluted net income per share was $5.2 million and $0.08, respectively, for the three months ended September 30, 2010, and $5.3 million and $0.08, respectively, for the three months ended September 30, 2009. On a similar basis, diluted net income and diluted net income per share was $15.7 million and $0.24, respectively, for the nine months ended September 30, 2010, and $11.7 million and $0.18, respectively, for the nine months ended September 30, 2009. We believe that excluding these adjustments provides information to better analyze our operations between periods and over time. Investors should consider these non-GAAP measures in addition to, and not as a substitute for, financial measures prepared in accordance with GAAP.

A reconciliation of the non-GAAP measures to the most comparable GAAP measures is included below:

Table of Contents

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
	(in thousands, except share and per-share amounts)			
GAAP Net Income	$ 1,219	$ 1,432	$ 2,676	$ 2,736
Net Effect of Tax Receivable Agreement	461	711	440	1,197
Non-GAAP Net Income	$ 758	$ 721	$ 2,236	$ 1,539
GAAP Non-Controlling Interest of Pzena Investment Management, LLC	$ 7,722	$ 8,082	$ 23,483	$ 17,767
Less: Assumed Corporate Income Taxes	3,309	3,463	10,063	7,613
Assumed After-Tax Income of Pzena Investment Management, LLC	$ 4,413	$ 4,619	$ 13,420	$ 10,154
Non-GAAP Net Income of Pzena Investment Management, Inc.	758	721	2,236	1,539
Non-GAAP Diluted Net Income	$ 5,171	$ 5,340	$ 15,656	$ 11,693
Non-GAAP Diluted Earnings Per Share Attributable to Pzena Investment Management, Inc. Common Stockholders:				
Non-GAAP Net Income for Diluted Earnings per Share	$ 5,171	$ 5,340	$ 15,656	$ 11,693
Non-GAAP Diluted Earnings per Share	$ 0.08	$ 0.08	$ 0.24	$ 0.18
Non-GAAP Diluted Weighted Average Shares Outstanding	64,993,746	64,994,278	65,006,198	64,756,331

Liquidity and Capital Resources

Historically, the working capital needs of our business have primarily been met through cash generated by our operations. Distributions to members of our operating company and loan amortization payments have been our largest use of cash from financing activities. Investing activities have historically been investments in our own investment strategies and, to a lesser extent, capital expenditures.

At September 30, 2010, our cash and cash equivalents was $26.8 million. Advisory fees receivable were $14.2 million.

We expect to fund the liquidity needs of our business in the next twelve months, and over the long term, primarily through cash generated from operations. As an investment management firm, our business has been materially affected by conditions in the global financial markets and economic conditions throughout the world. Our liquidity is highly dependent on the revenue and income from our operations, which is directly related to our levels of AUM. As of and for the three months ended September 30, 2010, our weighted average AUM and revenues increased by 11.5% and 10.1%, respectively, compared to the three months ended September 30, 2009. These increases contributed to a 28.6% increase in our cash provided by operating activities for the comparable period. As of and for the nine months ended September 30, 2010, our weighted average AUM and revenues increased by 32.7% and 27.5%, respectively, compared to the nine months ended September 30, 2009. These increases contributed to a 35.2% increase in our cash provided by operating activities for the comparable period.

In determining the sufficiency of liquidity and capital resources to fund our business, we regularly monitor our liquidity position, including, among other things, cash, working capital, investments, long-term liabilities, lease commitments, debt obligations, and operating company distributions. Further, we consider cash compensation, one of our largest expenses, as sufficiently variable such that it can be adjusted to mitigate any potential decline in revenue we may experience in the next twelve months. We continuously evaluate our staffing requirements and

compensation levels with reference to our own liquidity position and external peer benchmarking data. The result of this review directly influences management s recommendations to our Board of Directors with respect to such staffing and compensation levels.

We anticipate that distributions to the members of our operating company, which consisted of 34 of our employees, certain unaffiliated persons, two former employees, and us, will continue to be a material financing activity.

During the nine months ended September 30, 2010, we repaid the remaining $10.0 million principal amount outstanding of the Senior Subordinated Notes held by the entities established by Richard S. Pzena. Although we are comfortable with our current capital structure, in the current economic environment, it is uncertain whether additional or alternative sources of debt or equity financing, if required, would be available on acceptable terms.

We do not anticipate meaningful outlays for internal investment or capital expenditures over the next twelve months.

We believe that the repayment of our term loan and Senior Subordinated Notes, and our ability to vary cash compensation levels, have provided us with an appropriate degree of flexibility in providing for our liquidity needs.

Dividend Policy

We are a holding company and have no material assets other than our ownership of membership interests in our operating company. As a result, we depend upon distributions from our operating company to pay any dividends that our Board of Directors may declare to be paid to our Class A common stockholders. When, and if, our Board of Directors declares any such dividends, we then cause our operating company to make distributions to us in an amount sufficient to cover the amount of the dividends declared. Our dividend policy has certain risks and limitations, particularly with respect to liquidity. We may not pay dividends to our Class A common shareholders in amounts that have been paid to them in the past, or at all, if, among other things, we do not have the cash necessary to pay our intended dividends. To the extent we do not have cash on hand sufficient to pay dividends in the future, we may decide not to pay dividends. By paying cash dividends rather than investing that cash in our future growth, we risk slowing the pace of our growth, or not having a sufficient amount of cash to fund our operations or unanticipated capital expenditures, should the need arise.

Term Loan and Senior Subordinated Notes

During the year ended December 31, 2009, we used cash generated from operations to repay the remaining $22.0 million of the principal amount outstanding under our term loan. Concurrently with the termination of this term loan, a security interest in our accounts receivable and one of our subsidiaries was released by the lender in September 2009.

During the nine months ended September 30, 2010, we used cash on hand to repay the remaining $10.0 million principal amount outstanding of the Senior Subordinated Notes held by the entities established by Richard S. Pzena.

Tax Receivable Agreement

Our purchase of Class B units of our operating company concurrently with our initial public offering, and the subsequent and future exchanges by holders of Class B units of our operating company for shares of our Class A common stock (pursuant to the exchange rights provided for in the operating company s operating agreement), has resulted in, and is expected to continue to result in, increases in our share of the tax basis of the tangible and intangible assets of our operating company at the time of our acquisitions and these subsequent and future exchanges, which will increase the tax depreciation and amortization deductions that otherwise would not have been available to us. These increases in tax basis and tax depreciation and amortization deductions have reduced, and are expected to continue to reduce, the amount of tax that we would otherwise be required to pay in the future. We have entered into a tax receivable agreement with the current members of our operating company, the one member of our operating company immediately prior to our initial public offering who sold all of its Class B units to us in connection with our initial public offering, and any future holders of Class B units, that requires us to pay them 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax that we actually realize (or are deemed to realize in the case of an early termination payment by us, or a change in control, as described in the tax receivable agreement) as a result of the increases in tax basis described above and certain other tax benefits related to entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

In October 2008, the selling unitholders agreed to waive any payments that we were required to make to them for the 2008 and 2009 tax years pursuant to the tax receivable agreement.

Cash Flows

Operating activities provided cash of $9.9 million and $7.7 million for the three months ended September 30, 2010 and 2009, respectively. Operating activities provided $37.5 million and $25.6 million for the nine months ended September 30, 2010 and 2009, respectively. The year-over-year increase in cash flows from operating activities was driven primarily by an increase in weighted average AUM from $12.2 billion for the three months ended September 30, 2009, to $13.6 billion for the three months ended September 30, 2010, and an increase in weighted average AUM from $10.7 billion for the nine months ended September 30, 2009, to $14.2 billion for the nine months ended September 30, 2010, which had a corresponding positive impact on total revenues.

Investing activities consist primarily of investments in affiliates and other investment partnerships, as well as capital expenditures. Investing activities used less than $0.1 million for each of the three months ended September 30, 2010 and 2009. Investing activities provided less than $0.1 million for the nine months ended September 30, 2010, and had no net effect for the nine months ended September 30, 2009.

Table of Contents

Financing activities consist primarily of borrowing arrangements and distributions to and contributions from non-controlling interests. Financing activities used $6.6 million and $14.4 million of cash for the three months ended September 30, 2010 and 2009, respectively. The $7.8 million decrease in financing activities is primarily attributable to a $10.0 million decrease in principal repayments associated with our debt obligations, offset by a $1.6 million increase in distributions to non-controlling interests, a $0.3 million decrease in contributions from non-controlling interests, and a $0.3 million increase in dividends paid.

Financing activities used $26.5 million and $33.9 million for the nine months ended September 30, 2010 and 2009, respectively. The $7.4 million decrease in financing activities is primarily attributable to a $12.0 million decrease in principal repayments associated with our debt obligations and a $4.0 million increase in contributions from non-controlling interests, offset by a $8.0 million increase in distributions to non-controlling interests and a $0.6 million increase in dividends paid.

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of September 30, 2010.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and judgments that affect our reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under current circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily available from other sources. We evaluate our estimates on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

Accounting policies are an integral part of our financial statements. A thorough understanding of these accounting policies is essential when reviewing our reported results of operations and our financial condition. Management believes that the critical accounting policies discussed below involve additional management judgment due to the sensitivity of the methods and assumptions used.

Consolidation

Our policy is to consolidate all majority-owned subsidiaries in which we have a controlling financial interest and VIEs of which we are deemed to be the primary beneficiary. We also consolidate non-VIEs which we control as the general partner or managing member. We assess our consolidation practices regularly, as circumstances dictate. All significant inter-company transactions and balances have been eliminated.

Income Taxes

We are a C-corporation under the Internal Revenue Code, and thus liable for federal, state and local taxes on the income derived from our economic interest in our operating company. The operating company is a limited liability company that has elected to be treated as a partnership for tax purposes. Our operating company has not made a provision for federal or state income taxes because it is the responsibility of each of the operating company s members (including us) to separately report their proportionate share of the operating company s taxable income or loss. Similarly, the income of our consolidated investment partnerships is not subject to income taxes, as such income is allocated to each partnership s individual partners. The operating company has made a provision for New York City Unincorporated Business Tax (UBT).

We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, net operating loss carryforwards and tax credits. A valuation allowance is maintained for deferred tax assets that we estimate are more likely than not to be unrealizable based on available evidence at the time the estimate is made. Determining the valuation allowance requires significant management judgments and assumptions. In determining the valuation allowance, we use historical and forecasted future operating results, based upon approved business plans, including a review of the eligible carryforward periods, tax planning opportunities and other relevant considerations. Each quarter, we re-evaluate our estimate related to the valuation allowance, including our assumptions about future profitability.

We believe that the accounting estimate related to the $61.4 million valuation allowance, assessed as of September 30, 2010 against the deferred tax asset associated with our acquisitions of operating company Class B units, is a critical accounting estimate because the underlying assumptions can change from period to period. For example, tax law changes, or variances in future projected operating performance, could result in a change in the valuation allowance. If we were not able to realize all or part of our net deferred tax assets in the future, an adjustment to our deferred tax assets valuation allowance would be charged to income tax expense in the period such determination was made.

Table of Contents

Management judgment is required in determining our provision for income taxes, evaluating our tax positions and establishing deferred tax assets and liabilities. The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to earnings would result.

Recent Accounting Pronouncements

In September 2009, the FASB issued a new standard that requires an enterprise to perform a qualitative analysis to determine whether its variable-interests give it a controlling financial interest in a VIE. Under the standard, an enterprise has a controlling financial interest when it has (a) the power to direct the activities of a VIE that most significantly impact the entity s economic performance, and (b) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. An enterprise that holds a substantive interest and a controlling financial interest in a VIE is deemed to be the primary beneficiary of the VIE and is required to consolidate the VIE. The standard also requires an ongoing assessment of whether an enterprise is the primary beneficiary of a VIE, and additional disclosures about an enterprise s involvement in VIEs, and any significant changes in risk exposure due to that involvement. The standard is effective for fiscal years beginning after November 15, 2009. In November 2009, the FASB issued a proposed standard update, which defers the consolidation criteria requirements of this new standard for assets managers interests in entities that apply the specialized accounting guidance for investment companies, or that have the attributes of investment companies. In February 2010, the FASB issued further guidance which provided a limited scope deferral for a reporting entity s interest in an entity that meets all of the following conditions: (a) the entity has all the attributes of an investment company as defined under AICPA Audit and Accounting Guide, Investment Companies, or does not have all the attributes of an investment company but is an entity for which it is acceptable based on industry practice to apply measurement principles that are consistent with the AICPA Audit and Accounting Guide, Investment Companies, (b) the reporting entity does not have explicit or implicit obligations to fund any losses of the entity that could potentially be significant to the entity, and (c) the entity is not a securitization entity, asset-backed financing entity or an entity that was formerly considered a qualifying special-purpose entity. The reporting entity is required to perform a consolidation analysis for entities that qualify for the deferral in accordance with previously issued guidance on VIEs. We have evaluated the deferral guidelines and determined that the standard is applicable for our investment in our operating company, but that we meet the criteria for deferral provided in this standard for our VIEs. We adopted the updated guidance on January 1, 2010, and it had no impact on our consolidated financial statements. We are monitoring future guidance for updates on the treatment of our interests in our VIEs.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Market Risk

Our exposure to market risk is directly related to our role as investment adviser for the institutional separate accounts we manage and the retail clients for which we act as a sub-investment adviser. Global markets have experienced unprecedented volatility, and the current economic environment is challenging. Market conditions have, in the recent past, resulted in a significant reduction in our AUM, which in turn directly impacted our revenues and net income. A resumption of the economic downturn, and volatility in the global financial markets, could also significantly affect the estimates, judgments, and assumptions used in the valuation of our financial instruments.

All of our revenue for the three and nine months ended September 30, 2010 and 2009 was derived from advisory fees, which are typically based on the market value of AUM, which can be affected by adverse changes in interest rates, foreign currency exchange and equity prices. Accordingly, a decline in the prices of securities would cause our revenue and earnings to decline due to a decrease in the value of the assets we manage. In addition, such a decline could cause our clients to withdraw their funds in favor of investments offering higher returns or lower risk, which would cause our revenue and earnings to decline further.

We are also subject to market risk due to a decline in the value of holdings in mutual funds. At September 30, 2010, the fair value of these assets was $2.3 million. Assuming a 10% increase or decrease, the fair value would have increased or decreased by $0.2 million at September 30, 2010.

Interest Rate Risk

We have no exposure to interest rate risk at September 30, 2010.

Table of Contents

Item 4. Controls and Procedures.

During the course of their review of our consolidated financial statements as of September 30, 2010, our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2010, our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There have not been any changes in our internal control over financial reporting during the three and nine months ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

In the normal course of business, we may be subject to various legal and administrative proceedings.

Currently, there are no material legal proceedings pending against us.

Item 1A. Risk Factors.

There are no material changes from the risk factors set forth in Part 1, Item 1A of the Company s 2009 Annual Report on Form 10-K.

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.

Exhibit	Description of Exhibit
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15(d)-14(a)
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15(d)-14(a)
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

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.

Dated: November 4, 2010

PZENA INVESTMENT MANAGEMENT, INC.

By:	/s/ RICHARD S. PZENA	
	Name:	Richard S. Pzena
	Title:	*Chief Executive Officer*
By:	/s/ GREGORY S. MARTIN	
	Name:	Gregory S. Martin
	Title:	*Chief Financial Officer and Principal Accounting Officer*