

iRobot Fourth-Quarter and Full Year 2013 Conference Call Script

Operator:

Good day everyone and welcome to the iRobot fourth-quarter and full year 2013 financial results conference call. This call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to Elise Caffrey of iRobot Investor Relations. Please go ahead.

Elise:

Thank you and good morning. Before I introduce the iRobot management team, I would like to note that statements made on today's call that are not based on historical information are forward-looking statements made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995.

This conference call may contain express or implied forward-looking statements relating to the company's financial results and operations for fiscal 2014 and the first quarter ending March 29, 2014, the growth and revenue impact of our businesses including international growth, our expectations regarding profitability, our expectations regarding revenue, the rate of revenue growth, Adjusted EBITDA, Adjusted EBITDA margin, operating cash flow, operating expenses, gross margins, operating margins, restructuring charges, stock compensation expenses, depreciation and amortization expenses, tax rates, shares outstanding and earnings per share, the impact of our continued investment in quality and improved operational performance, demand for our home robots, international home robot revenue, the impact of our Braava® robot on our financial results, the timing and fulfillment of government contracts and orders, demand for and adoption of our Defense and Security robots and related parts and services, orders for and sales and deliveries of our PackBot®, SUGV and FirstLook® robots, our Defense and Security contract, product lifecycle and recurring revenue, international Defense and Security revenue, mix of product revenue and impact on operating margins, our plans for expansion, our introduction and delivery of new products and

new product capabilities and functionality, demand for and the impact of our new Scooba® robot, the timing of the launch of our Ava® 500 robot, the impact of our RP-VITA robot on our financial results, the availability, capabilities and functionality of new technology including navigation technology, and the impact of our related investments, our competitive position, our market share, and business conditions. These statements are neither promises nor guarantees, but are subject to a variety of risks and uncertainties, many of which are beyond our control, which could cause actual results to differ materially from those contemplated in the forward-looking statements. In particular, the risks and uncertainties include those contained in our public filings with the Securities and Exchange Commission. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. iRobot undertakes no obligation to update or revise these forward-looking statements, whether as a result of new information, future events or circumstances or otherwise.

During this conference call, we will also disclose non-GAAP financial measures as defined by SEC Regulation G, including Adjusted EBITDA, which we define as earnings before interest, taxes, depreciation, amortization, merger and acquisition expenses, restructuring expenses, net intellectual property litigation expenses and non-cash stock compensation expense. A reconciliation between Adjusted EBITDA and net income – the GAAP measure most directly comparable to Adjusted EBITDA - is provided in the financial tables at the end of the Q4 and full year 2013 earnings press release issued last evening, which is available on our website <http://investor.irobot.com/phoenix.zhtml?c=193096&p=irol-EventDetails&EventId=5041606>.

A live audio broadcast of this conference call is also available on the Investor Relations page of our website and an archived version of the broadcast will be available on the same Web page following the call. In addition, a replay of this conference call will be available through February 13, 2014 and can be accessed by dialing **630-652-3042**, access code **35939059#**.

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the fourth quarter and full year 2013 as well as our outlook on the business for 2014; Alison Dean, Chief Financial Officer, will review our financial results for the fourth quarter and full year 2013; and, Colin and Alison will also provide our financial expectations for the first quarter ending March 29, 2014 and fiscal 2014. Then we'll open the call for questions.

At this point I'll turn the call over to Colin Angle.

Colin:

Good morning and thank you for joining us.

2013 was a great year for iRobot. Last evening, we reported Q4 and full year results in line with our expectations. Home Robot revenue grew **20%**, driving full-year 2013 company revenue up **12%** to **\$487** million despite the anticipated **30%** decline in D&S revenue. Earnings per share were **\$0.94**. Adjusted EBITDA was **\$62** million or **13%** of revenue. All three of our businesses met our expectations and made significant progress against their strategic plans, setting us up well for 2014.

In 2014 our financial performance will continue to be driven by our Home Robot business. Home Robot revenue is expected to grow **17-20%** in 2014 and comprise **90%** of total company revenue. Our Defense & Security business is expected to perform at 2013 levels, and our Remote Presence business will be shipping product into two markets.

For 2014, we expect revenue of **\$560** to **\$570** million; EPS of between **\$1.00** and **\$1.15** and adjusted EBITDA of **\$74** to **\$78** million or roughly **14%** of revenue. These expectations are a strong next step in progressing towards our three year targets of:

- Mid-high teen revenue CAGR,
- High teen Adjusted EBITDA margin and,
- High single digit Operating Cash Flow margin

Now I'll take you through some of the details of 2013 and our expectations for 2014.

- Our Home Robot business had a phenomenal year. Revenue grew **20%** for the full year over 2012, and comprised **88%** of the company's total revenue for the year;
- Our Defense & Security business delivered results consistent with our expectations while continuing to reduce reliance on the DoD, and;

- Our Remote Presence business began shipping RP-VITA telemedicine robots for use in hospitals to our partner InTouch Health and we signed a marketing agreement with Cisco to sell our Ava 500 Video Collaboration robots.

Full year Home Robot revenues were driven by strong growth in both domestic and international markets. Expanded distribution of Roomba 700 and 600 series and the introduction of Braava overseas were the primary drivers. In the fourth quarter we launched our next generation Roomba, the 880, with revolutionary AeroForce technology that we think will change the way the world vacuums. The brushless design, with counter-rotating debris extractors, coupled with significantly greater vacuum power, makes ours a truly differentiated and superior product. Sales of the product to date from our website have exceeded those of all other new products over the same timeframe.

At CES in January of this year we introduced our first major new large-format Scooba floor washing robot in nearly **8** years. The Scooba 450 model addresses customer feedback we've received since we first launched the product in 2006. It delivers improved cleaning performance through its three-cycle cleaning process and significantly improved usability through technology and easy-to-clean design. We think there is a large addressable market, both domestically and overseas, for Scooba.

Our continued investment in marketing programs to generate greater brand awareness helped drive full year domestic revenue growth of more than **30%** over last year. Likewise, our commitment to continuous improvement resulted in a reduction to our product returns accrual that positively impacted revenue and profit for the year. Higher quality robots and improved operational performance coupled with a premium ad campaign have proven to be a successful formula. We will continue to invest in these and other initiatives that expand our competitive moat and secure our market-leading position.

Our 2013 international Home Robot revenues grew **14%** year-over-year. Revenue in APAC, driven by strong demand in Japan and China, increased more than **40%**. As anticipated, EMEA declined approximately **5%** driven by regional macros, slightly offsetting the strong APAC growth. As I mentioned last quarter, our European distributors are reporting improving demand in EMEA, and we expect the region to contribute to 2014 growth. For 2013, APAC and EMEA each comprised roughly **30%** of Home Robot revenue.

We expect strong 2014 growth in each of our three markets, U.S., APAC and EMEA, to be driven by expanded distribution of Roomba 880, Braava and Scooba 450, deeper penetration of existing markets and further expansion in China. Growth in APAC will continue to be driven by Japan and China. In EMEA we are expecting increasing demand from long time western European distributors to fuel growth in that region.

The robotic vacuum cleaner market grew roughly **30%** from 2010 through 2012 and represents approximately **15%** of vacuum cleaner sales. That revenue share is comparable to the level of other disruptive household appliances, such as the microwave oven and dishwasher, at the same stage of their lifecycles, **10 to 15** years following introduction. We believe that as awareness of the category continues to expand, we could see an adoption rate similar to those other appliances.

We are optimistic about our ability to capture an increasing slice of the global robotic floor care market and expect our Home Robot business to drive the company's targeted mid-high teen growth through 2016. Our go to market strategies have served us well and will not change in 2014. As always, we will balance continuing investments to support growth initiatives with generating increased profitability.

Turning now to our Defense & Security business, full year results were in line with our overall expectations. Roughly **50%** of revenue was product lifecycle revenue and **40%** was robot sales, primarily PackBot and FirstLook robots. The remaining **10%** was from externally funded R&D. International revenue increased to roughly **30%** of full year D&S

revenue from approximately **10%** in 2012, while the DoD comprised **60%** of total 2013 revenues compared with **87%** last year.

Visibility into the DOD market remains poor. In 2014, we will continue to focus on the international and first responder markets as well as continuing to sell spares, service and support for the installed base of more than 5,000 iRobot unmanned ground vehicles.

In 2013, we began shipping our FDA approved Ava robot to InTouch Health (ITH). They in turn integrated their proprietary technology for telemedicine on the units and shipped the RP-VITAs to hospitals across the United States and Mexico for use in remote diagnosis and treatment. During the fourth quarter we sold roughly **\$1** million of product and are very excited about our progress in this segment. We believe that as more and more hospitals, doctors and patients recognize the value of RP-VITA, its use will expand.

During the year we announced a very exciting joint marketing agreement with Cisco to bring the enterprise-grade Ava 500 Video Collaboration Robot to market with Cisco. We also signed an agreement with KBZ, a major Cisco distributor. Ava 500 is in beta with several global 2000 companies from various industries. All is going according to plan and we are anticipating a product launch in the first half of 2014.

iRobot views indoor mapping as a long term strategic technology asset of the company. Our Ava platform is our first of many products through which we are monetizing this capability.

In summary, 2013 was a very successful year following a challenging transitional 2012. In 2014:

- Home Robot revenue will continue to grow in both domestic and overseas markets and comprise roughly **90%** of total company revenue;

- We will continue to invest in marketing programs and ongoing quality initiatives that drive profitable Home Robot growth;
- We will expand our reach in the health care telepresence and video collaboration markets,
- We will continue to track developments in Washington and elsewhere that impact our Defense and Security business, and;
- We will continue to invest in key technologies that extend our market-leading position in practical robotics.

I will now turn the call over to Alison to review our fourth quarter and full year results in more detail.

Alison

Our fourth quarter revenue, earnings per share and Adjusted EBITDA were in-line with our expectations. Revenue of **\$126** million increased **25%** from Q4 last year driven by growth in Home Robot revenue. EPS was **\$0.11** for the quarter compared with a loss of **(-\$0.21)** for the same period last year. Q4 Adjusted EBITDA was **\$13** million compared with **\$1** million last year.

Domestic Home Robot revenue growth was **50%** for Q4 and **31%** for the year, further evidence that our advertising investments, product and channel strategies and quality initiatives are yielding positive results. Q4 domestic revenue was partially impacted by another favorable adjustment to the product return accrual of **\$3.6** million (**\$4.4M** in total). We have seen favorable adjustments on and off over the last few years as we have seen our return rates declining. International revenue grew **14%** for the full year driven by APAC growing more than **40%**, partially offset by a year-over-year decline of **5%** in EMEA.

I am happy to report that after our first full year post acquisition of Evolution Robotics, we achieved our revenue and gross margin targets for the year, as well as the planned EBITDA accretion in Q4. As we have now fully integrated this business into our Home Business Unit, we will no longer report on it separately.

Defense & Security revenue of **\$16** million in Q4 was flat year over year. Roughly **70%** of this quarterly revenue was from PLR and the balance was from robot sales.

For the total company, gross margin was **47%** for the fourth quarter and **45%** for the full year 2013. As a reminder, the returns adjustments carry **100%** gross margin.

Q4 operating expenses were **43%** of revenue, down from **53%** in Q4 last year when we recorded acquisition costs associated with Evolution Robotics (ER) and booked the

majority of our D&S restructuring charges. Full year 2013 operating expenses came in at **39%**, roughly flat with last year.

EBITDA for the quarter was **\$13** million compared with **\$1** million last year; with full year 2013 results of **\$62** million or almost **13%**, compared with **\$52** million or **12%** last year. EPS in Q4 was **\$0.11**, and **\$0.94** for the full year. Our full year annualized tax rate for 2013 was **15%** and was impacted by the 2012 and 2013 Investment tax credits, as well as a one-time tax benefit on Extra Territorial Income from 2000 to 2006. The combination of these **3** items was approximately **\$0.18** favorable impact on 2013 EPS.

Q4 operating cash flow was **\$31** million resulting in full year 2013 OCF of **\$42** million, **9%** of full year revenue. We ended the year with **\$187** million in cash, up from **\$139** million a year ago, and with **\$46** million in inventory or **63** days, compared with **\$37** million or **61** days last year.

Now I'd like to provide you with additional detail and some of the underlying assumptions for our Q1 and full year 2014 financial expectations. The outlook for our Home Robot business remains very strong with growth drivers identified for the next couple of years. For the Defense & Security business, our visibility is again limited in 2014 however we expect our continued focus on international, first responder markets and PLR to result in revenues comparable to 2013 levels. We expect Remote Presence revenue to increase in 2014 but to not contribute materially to growth.

We expect full year revenue of **\$560** to **\$570** million comprised of Home Robot revenue of **\$500** to **\$515** million and D&S revenue of roughly **\$50** million. We anticipate increased revenue from Remote Presence to contribute approximately **\$5** million. We anticipate our quarterly revenue pattern to differ from 2013 with roughly **55%** coming in the second half of the year as we steadily roll out our new home robots. We anticipate Home Robot revenue to grow **13-15%** in Q1 2014 over last year while D&S revenue is

expected to decline in the first quarter. As a result, we expect total company Q1 revenue to increase roughly **5%** to **\$110** to **\$113** million, and to increase sequentially quarter to quarter throughout the remainder of the year.

In Home Robots, growth will be driven by further penetration of long time overseas markets, coupled with expansion in China and wider distribution of the Roomba 800, Scooba 450 and Braava. Overall, we expect home robots to grow **17-20%** in 2014.

We expect approximately **45%** of D&S revenue to come from robot sales, **50%** from PLR to support the installed base of robots, and the balance from contract revenue. Because it is expected to be nominal, contract revenue will be reported as part of total D&S revenue beginning with our Q1 2014 earnings release.

We expect Q1 EPS of **\$0.13** to **\$0.17** and full-year EPS of **\$1.00** to **\$1.15**. Adjusted EBITDA in Q1 is expected to be **\$13** to **\$15** million and for the full-year is expected to be **\$74** to **\$78** million.

Consistent with our commitment to improve profitability through opex leverage, we expect 2014 operating expenses to decrease to approximately **36%** of revenue for the full year down from **39%** in 2013. We expect operating cash flow to continue to run in the high single digits as a percentage of revenue.

We are also assuming:

- Gross margin of roughly **45%**
- Stock comp expense of roughly **\$15** million;
- Depreciation and amortization expense of approximately **\$15** million; and,
- Diluted share count of approximately **30** million shares.

We are estimating a tax rate of **32%** to **35%** for 2014. The lower end of this range would require a 2014 investment tax credit to be approved. I'll now turn the call back to Colin.

Colin

We expect our Home Robot business to deliver robust results in 2014; our stable defense business to be flat year over year; and remote presence to contribute to growth though not materially in 2014. With our Home Robot business comprising roughly **90%** of our revenue, we expect to deliver mid to high teen company growth, consistent with our three year financial targets.

With that we'll take your questions.

Following Q&A**Colin**

That concludes our fourth quarter and full year 2013 earnings call. We appreciate your support and look forward to talking with you again in April to discuss our Q1 results.

Operator

That concludes the call. Participants may now disconnect.