

iRobot Second-quarter 2012 Conference Call Script

July 24, 2012

Operator:

Good day everyone and welcome to the iRobot second-quarter 2012 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 full year 2012 and the third quarter ending September 29, 2012, our expected quarterly and second-half financial performance, the mix of total revenue and product revenue, seasonality, the timing of orders and order fulfillment, our expectations regarding revenue growth, Adjusted EBITDA margin, operating cash flow, operating expenses and gross margins, our plans to expand into new markets and the distribution of our robots, international demand and growth, demand for our home robots, domestic and international home robot revenue, our introduction and delivery of new products and new product capabilities and functionality, demand for and adoption of our Defense & Security robots and related parts and services, including the timing of government contracts and orders for our PackBot, SUGV and FirstLook robots, our marketing initiatives and the associated impact, new market opportunities, the availability and impact of our new technology, 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.. A reconciliation between Adjusted EBITDA and net income – the GAAP measure most directly comparable to Adjusted EBITDA -- are provided in the financial tables at the end of the second quarter 2012 earnings press release issued last evening, which is available on our website <http://investor.irobot.com/phoenix.zhtml?c=193096&p=irol-news&nyo=0>. 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 August 1, 2012 and can be accessed by dialing 630-652-3042, access code 32828728#.

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the second quarter of 2012 as well as our business outlook for the rest of 2012; and John Leahy, Chief Financial Officer, will review our financial results for the second quarter and provide our financial expectations for the full year 2012 and the third quarter ending September 29, 2012. 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.

I am pleased to report that the company's second-quarter performance was very good given the challenging environment. Total Q2 revenue of **\$111** million was at the high end of our expectations for the quarter while Adjusted EBITDA of **\$16** million and EPS of **\$0.26** for the quarter, both far exceeded our expectations. Our continuing investment to improve Home Robot product quality resulted in an adjustment to our product returns accrual which positively impacted revenue and profit by approximately **\$3** million.

Yesterday we announced, with InTouch Health, the unveiling of the RP-VITA™ telemedicine robot. The robot combines InTouch Health's state-of-the-art telemedicine solutions with iRobot's autonomous navigation capabilities, mobility, interactive communication and situational awareness from the Ava program. It's the first commercial robot based on our Ava technology and our most significant technological system since SUGV.

Our Home Robot business unit had an outstanding quarter and the outlook for that business is excellent. Strong growth in both our international and U.S. markets fueled a **50%** year over year increase in Home Robot revenue. We are successfully expanding our distribution of new products and increasing our market penetration. In both the third and fourth quarters, expanded product distribution and strong demand both domestically and overseas will drive year-over-year revenue growth of more than **20%**.

U.S. government funding and program delays, however, continue to negatively impact our expectations for the Defense & Security business unit. We have received notification of contract delays for both FirstLook and the two BCTM combat brigades which we expected to drive second half revenue in that business unit.

Our steadily increasing Home Robot global reach is enabling us to substantially offset the impact of U.S. government spending issues on our Defense & Security business. Therefore, we are reaffirming our expectations for full year 2012 revenue, which we provided in February and affirmed in April and increasing our expectations for full year 2012 EPS and Adjusted EBITDA. We anticipate full year 2012 revenue between **\$465** million and **\$485** million, EPS of between **\$0.90 and \$1.00** and Adjusted EBITDA of **\$59-\$63** million.

For the third quarter we anticipate revenue of **\$125-\$130** million, EPS between **\$0.30** and **\$0.36** and Adjusted EBITDA of **\$17-\$20** million.

Now, I'd like to take you through some of the details of the second quarter and our expectations for the rest of 2012.

In Home Robots, expanded distribution of our Roomba 700 domestically and very strong demand overseas, particularly in Japan, continued to fuel revenue growth. Asia Pacific grew more than **85%** in the second quarter and totaled approximately **30%** of Home Robot revenue in Q2. Our business continues to thrive in Europe despite the negative news that has dominated the headlines. Total EMEA revenue grew **42%** in Q2 over last year and Western Europe, which comprised approximately **30%** of Home Robot revenue, grew **40%**. Overall international Home Robot revenue increased **56%** year-over-year. We have partnered with distributors who understand their markets and our products well and we expect international Home Robot demand to contribute significantly to revenue for the remainder of 2012.

I'm particularly excited to report that our plans to revitalize our U.S. business are succeeding. Domestic revenue grew nearly **40%** over second quarter last year following an impressive **21%** increase in Q1. These results were driven by expanded distribution of Roomba 700 into U.S. retailers. Our continued investment in marketing to reach our target customer, the modern professional, was increased in the second quarter to support the expanded distribution. Proof that our efforts, in particular the Q2

advertising campaign, have been effective is evidenced in higher Roomba and iRobot awareness scores as measured by an independent source as well as significantly stronger sell through as reported by our domestic retail partners. During the six week campaign, the daily average of home robots sold to consumers in the U.S. increased approximately **50%** from the daily average sold during the **15** weeks preceding the campaign. Over the past year we have talked about the importance of investing in brand and marketing to support our growth plans. We saw the positive impact of our investments in the first half and expect our programs to drive even greater awareness in the U.S. market in 2012.

In addition to successful expansion of the Roomba 700, we continue to see demand for our Scooba 230 product, which is being sold on our website and in select European markets. Revenue from the Roomba 700 and Scooba 230 comprised more than **50%** of Home Robot revenue in the second quarter. Expanding our distribution of both products throughout the rest of 2012 will continue to drive increased revenue.

Since our last call, we have announced new contracts totaling approximately **\$27** million for SUGV and PackBot robots, spares and software upgrades that we will deliver over the remainder of 2012. We are currently performing work under the BCTM bridge development contract and expect to sign a direct contract with the government later this year.

In June, the FirstLook robot was the top performer in the Ultra Light Recon Robot competition at the Joint IED Defeat Organization's first challenge-based acquisitions event at the U.S. Army Robotics Rodeo. Among the participants were our three competitors in the operational assessment underway in Afghanistan. Not only did we win the competition, but none of the other companies' robots finished in the top three. The event's main objective was to use robotics to discover new methods that will enable creating better speed and flexibility to maneuver in the counter-IED environment. The FirstLook robot's performance positions us well for the upcoming contract competition in

this weight class. Unfortunately, the solicitation for this robot has been delayed until October of this year and it is unclear whether the government will place any significant orders for FirstLook robots prior to contract award.

In addition, orders that we expected for approximately **76** SUGVs for BCTM brigades 4 & 5 have also been delayed. We expect to receive them in the fourth quarter and fulfill them in the first half of 2013.

Given leaner military budgets, there is an intense focus on doing more with less. Unmanned ground vehicles enable efficient achievement of mission objectives with fewer troops and we are well positioned with our SUGV and FirstLook robots to enable the government to meet its objectives. Limited visibility in our Defense & Security business presents near term challenges but we are working our way through them and hope to exit 2012 in a more positive position.

Finally, at the end of February we announced a management and structural realignment of the company for our next stage of evolution which we discussed on last quarter's call.

After combining the divisional engineering, operations and finance organizations into a shared service model to more effectively serve the business units, we identified a number of redundancies and inefficiencies and we took action in early July.

I will now turn the call over to John to review our second-quarter results and our Q3 and full-year expectations in more detail.

John

Thanks Colin.

Revenue for the second quarter was **\$111** million compared with last year's **\$108** million in revenue. Earnings per share and Adjusted EBITDA for the second quarter both exceeded our expectations. Earnings per share for the quarter were **\$0.26** compared with **\$0.29**, last year, and Adjusted EBITDA for Q2 was **\$16** million, flat with last year.

In Q2, we adjusted our accrual rates for Home Robot product returns, resulting in a positive benefit to revenue and earnings. Our returns experience has gradually improved as the result of our sustained investment in product quality. Revenue, EPS and Adjusted EBITDA would have been **\$108** million, **\$0.18** and **\$13** million respectively, without this adjustment.

For the first half, revenue was **\$209** million compared with **\$214** million in 2011; EPS was **\$0.28** compared with **\$0.56**; and Adjusted EBITDA was **\$22** million compared with **\$31** million last year.

Home Robot shipments grew **30%** while revenue of **\$96** million increased approximately **50%** from a year ago. International revenue increased **56%** in the quarter to **\$65** million and comprised **67%** of Home Robot revenue. Total domestic revenues were up significantly, nearly **40%** in Q2, following a **21%** increase in Q1. We now expect domestic revenues to grow more than **25%** for the full year – our best domestic performance in several years. Importantly, sell through at our top **5** domestic retailers was up nearly **35%** year over year reflecting the impact of our advertising campaign in Q2 and expanded distribution of products launched last year.

Defense & Security revenue of **\$15** million decreased from a year ago due to both lower contract and product revenue.

Defense & Security product revenue was **\$12** million in the second quarter, compared with **\$34** million last year. Product lifecycle revenue was **\$5** million. Backlog at the end of the quarter was **\$18** million and as of today the backlog totals approximately **\$28** million, the highest level since Q3 2011.

For the total company, gross margin was **44%** for the quarter, compared with **39%** last year. This improvement was largely driven by Home Robots which had a gross margin of **52%**. As Colin and I have mentioned, improved product quality benefited our product return accruals. Excluding this impact, Home Robot gross margins would have been **50%**, compared with **44%** last year. Product mix, lower warranty costs, and operating efficiency also contributed to the increase. Gross margin in our Defense & Security business improved from last quarter, despite lower revenue, as a result of cost reduction initiatives. We expect company gross margin to be **41-42%** for the full year 2012.

Operating expenses increased to **35%** of revenue in Q2 compared with **29%** last year. The increase was driven by a **50%** increase in sales & marketing for the quarter, reflecting the multi-media advertising program we kicked off in April. The second half of this campaign is scheduled for the fourth quarter to coincide with the holiday season. Internal R&D grew **20%** in Q2 as we accelerated development on Ava for the delivery of product to InTouch Health that Colin discussed. For the full year, we expect operating expenses to be approximately **33-34%** of revenue.

At the end of Q2, we had cash, including investments, totaling **\$177** million compared with **\$123** million last year and operating cash flow is breakeven on a year-to-date basis.

In Q3, we expect revenue of **\$125-\$130** million, a slight increase over last year, driven by strong growth in Home Robots. We expect EPS in the range of **\$0.30** to **\$0.36** and Adjusted EBITDA of **\$17- \$20** million. Please keep in mind that in Q3 2011 we recorded a one-time tax benefit which impacted EPS by **\$0.12**. Our full year revenue expectations

of **\$465 - \$485** million remain unchanged, however we now expect Home Robot revenue to grow more than **30%** to **\$365 - \$375** million and comprise almost **80%** of total company revenue. We anticipate Defense & Security revenue in the range of **\$100** to **\$110** million for the full year, with sequential growth in both Q3 and Q4. We have increased our full-year expectations for EPS to **\$0.90 - \$1.00** and Adjusted EBITDA to **\$59 - \$63** million.

Strong domestic sales growth, the expanded distribution of new products, and further penetration into long term international markets will drive the Home Robot business. Orders for SUGV robots from the U.S. military and block software upgrades of Defense & Security robots will support that business in the second half.

I'll now turn the call back to Colin.

Colin

Our results in the second quarter exceeded our expectations due to strong performance by our Home Robot business unit.

As we look at the rest of the year, we will extend our presence in existing markets and continue expansion in new geographic markets. Beyond this year, we see tremendous growth opportunities for our Home robots and are very excited about the prospects for Ava. While the current military climate is disappointing, the longer term drivers remain intact for our Defense & Security business, and we are well-positioned for those markets.

With that we'll take your questions.

Following Q&A

Colin

That concludes our second quarter earnings call. We appreciate your support and look forward to talking with you again in October to discuss our Q3 results.

Operator -That concludes the call. Participants may now disconnect.