

iRobot Second-Quarter 2014 Conference Call Script

Operator:

Good day everyone and welcome to the iRobot second-quarter 2014 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 third quarter ending September 27, 2014; our expectations regarding fiscal 2014 revenue from our businesses; our expectations regarding profitability; our expectations regarding revenue, the rate of revenue growth, Adjusted EBITDA, Adjusted EBITDA margin, operating cash flow, gross margins, operating expenses, marketing expenses, research and development expenses, general and administrative expenses, operating margins, restructuring charges, stock compensation expenses, depreciation and amortization expenses, tax rates, shares outstanding and earnings per share; demand for our home robots; our expectations regarding international expansion and international home robot revenue; the impact of our continued investment in advertising, our brand and quality initiatives; the impact of our Roomba 880[®] and Scooba[®] 450 robots on our financial results; timing of customer adoption of our Ava[®] 500 robot; the impact of our RP-VITArobot; the impact of our continued investment in new technology; the timing and fulfillment of contracts and orders for our Defense & Security robots; demand for and adoption of our Defense and Security robots and related parts and services; the mix of

product revenue and impact on operating margins; our introduction and delivery of new products and new product capabilities and functionality; 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 expense, restructuring expense, net intellectual property litigation expense 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 Q2 2014 earnings press release issued last evening, which is available on our website <http://investor.irobot.com/phoenix.zhtml?c=193096&p=irol-eventDetails&EventId=5041608>. 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 July 30, 2014 and can be accessed by dialing **630-652-3042**, access code **35939092#**.

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 2014 as well as our

outlook on the business for the remainder of 2014; Alison Dean, Chief Financial Officer, will review our financial results for the second quarter of 2014; and, Colin and Alison will also provide our financial expectations for the third quarter ending September 27, 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.

Last evening, we reported a successful second quarter, with results that met our expectations. Home Robot revenue grew **15%**, driving second quarter company revenue up **7%** to **\$140** million. Earnings per share were **\$0.28**. Adjusted EBITDA was **\$16** million or **11%** of revenue.

During the second quarter we:

- We expanded distribution of our latest Roomba 800 series robots across the United States and into most of our overseas distributors to meet overwhelming demand;
- We successfully worked to secure a number of Defense & Security orders which we'll deliver during the second half, and;
- We shipped several of our AVA 500 telepresence robots and set up trial periods for prospective customers to assess the value of our robots in their locations.

Additionally, based on increased confidence in Home Robots, we are raising the low end of our full-year revenue expectations for our Home Robot business to **\$505** million from **\$500** million. Further, strong backlog growth during the quarter in Defense & Security, coupled with several expected near term orders, and the overall growth of high probability pipeline has significantly improved visibility for 2014. The increased visibility has clarified that certain order deliveries are being requested by the customers for early 2015, resulting in a decrease of the 2014 revenue expectation for Defense & Security by **\$5** million to **\$45** million.

For the company, we now expect revenue of **\$555** to **\$565** million, driven by Home Robot growth of **18-20%**; EPS of between **\$1.10** and **\$1.20** and adjusted EBITDA of **\$74** to **\$78** million or roughly **14%** of revenue.

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

- Our Home Robot business continues to deliver strong growth on an ever-increasing base. Revenue growth in all three geographic regions contributed to year-over-year growth of **15%** for the quarter;
- Our Defense & Security business delivered results at the low end of our quarterly expectations, but secured several orders during the quarter and moved several other large opportunities into the near term pipeline, significantly improving visibility;
- Our Remote Presence business began shipping our Ava 500 Video Collaboration robot to customers.

Quarterly Home Robot revenues were driven by **19%** year-over-year growth in overseas markets as we extended Roomba 800 distribution throughout most of the region. Roomba 800 sales comprised **27%** of Q2 revenue which was ahead of our expectations. In the United States we have seen a tremendous response from the select retailers, with whom we first began our distribution rollout, which fueled replenishment orders. We expect to see this trend continue as the product reaches more stores and we get closer to the holiday season. Sell through at our top five retailers increased **30%** over last year. Sales of Roomba 800 robots through the second quarter on our website have exceeded those of all of our other new products over the same timeframe. Due to U.S. retailer and international distributor demand, distribution is ahead of our original plan. The product is now available in many domestic retail locations and is slowly being rolled out to retailers in European and Asian markets by our distributors.

The Scooba 450, our next generation floor-scrubbing robot, enjoyed early success on our website when we launched it in Q1. While Scooba and Braava, the products comprising our wet floor care category, are growing year over year, they are growing at a slower rate than Roomba. We have invested significantly in building awareness of Roomba over the past couple of years which has resulted in substantial growth. We are

still in the early days of better articulating the wet floor care value proposition and differentiating Scooba and Braava from Roomba in the retail environment, to fully realize the potential for this product category. To support expanding distribution of these products, we will shift some investment focus to building awareness of the wet floor care category over the next **12** months.

International Home Robot revenues grew **19%** year-over-year in the second quarter and we expect to see increased second half growth overseas as we receive replenishment orders for Roomba. EMEA grew approximately **20%** in Q2 fueled by the introduction of Roomba 800 into the region. Revenue growth in APAC, of **18%** year over year, was driven by strong demand in China.

In the fourth quarter we will kick off an advertising campaign featuring our Roomba 800 series robot to support our retail partners throughout the holiday season. The ads will focus on the product family's revolutionary Aeroforce[®] debris extractors, which to date have been showcased only on our website. Our continued investment in advertising and our brand will help drive increased awareness of the category and growth of the global robotic vacuum cleaner market.

Turning now to our Defense & Security business, second quarter results were at the low end of our expectations due to orders received late in the quarter that we will fulfill in Q3 and Q4. Roughly half of the **\$21** million in backlog at the end of Q2 is comprised of international orders, reflecting our significant marketing efforts overseas. The other half is orders from the DoD, all of which we expect to fulfill in 2014. We are also expecting additional orders in Q3. Our improved visibility in this business is the result of substantial order backlog, coupled with a significant percentage of high probability, near term pipeline opportunities. With increased visibility and orders received later than expected, we now expect Defense & Security Robot revenue of **\$45** million, down from **\$50** million, as several orders call for partial delivery in 2015.

Moving on to our Remote Presence business, we reported in Q1 that we launched the Ava 500 video collaboration robot in the United States, Canada and limited European markets through select certified Cisco resellers. We received our first orders and began shipping to customers in Q2.

We have a strong pipeline of requests of Fortune 1000 companies that are interested in Ava 500, many of which have completed, are currently engaged or scheduled for future trials. As predicted, all prospective customers to date want to use the robots on a trial basis in their respective environments prior to purchasing the product. Our focus for 2014 has been to build a base of reference accounts and we are well on our way to doing so.

Our RP-VITA telemedicine robot continues to gain traction as doctors, hospitals and patients realize the value of remote diagnosis. The feedback we are getting from doctors using our robot is that the user interface enabled by our navigation technology is proving to be highly valued in areas of telemedicine where frequent patient interaction is required such as in Intensive Care Units. As we are learning more about markets where iRobot can add value, the trend bodes well for RP-VITA.

In summary:

- Home Robot revenue grew **15%**, **is expected to** continue to grow in both domestic and overseas markets and is expected to drive full-year 2014 Home Robot growth of **18-20%** and total company growth of **14-16%**;
- Our visibility into full year Defense & Security revenue has improved significantly based on a **\$21** million backlog and a substantial number of large high probability pipeline opportunities;
- Customer interest remains high for our Remote Presence robots and we are seeing positive signs for this emerging market.

I will now turn the call over to Alison to review our second quarter results and expectations in more detail.

Alison

We delivered second quarter revenue and Adjusted EBITDA in-line with our expectations and earnings per share slightly ahead of expectations. Revenue of **\$140** million increased **7%** from Q2 last year driven by growth in Home Robot revenue. Q2 2014 includes approximately **\$1.2** million of favorable return reserve adjustments compared with **\$3.5** million in the second quarter of 2013. EPS was **\$0.28** for the quarter flat with Q2 last year. Q2, and first half, 2014 EPS was ahead of our expectations primarily due to a **\$0.07** benefit resulting from the release of a valuation allowance relating to certain tax attributes associated with our acquisition of Evolution Robotics. EPS in Q2, and first-half, 2013 also included a **\$0.07** one-time tax benefit associated with the prior period sale of government robots to the U.S. military, which were used outside of the U.S. Q2 Adjusted EBITDA was **\$16** million compared with **\$17** million last year.

For the first half, revenue was **\$254** million compared with **\$237** million in 2013; EPS was **\$0.46** compared with **\$0.57**; and Adjusted EBITDA was **\$30** million compared with **\$32** million last year.

Q2 international revenue grew **19%** over last year, driven by strong performance in China as well as growth in EMEA from expanded distribution of our new Roomba 880. Domestic Home Robot revenue grew **7%** for the quarter. We continue to expect high teen revenue growth in both domestic and overseas markets for the full year, driven primarily by replenishment orders for Roomba.

Defense & Security revenue of **\$5** million in Q2 was down year over year as expected. Roughly **75%** of this quarterly revenue was from international sales. During the quarter we built a **\$21** million backlog which gives us confidence in delivering full year revenue of **\$45** million.

For the total company, gross margin was **44%** for the second quarter 2014, down **300** basis points from the same quarter last year. Product mix and warranty reserves were the main drivers.

Q2 operating expenses were **38%** of revenue, down from **41%** in Q2 last year. We continue to expect operating expenses to be lower in the second half as a percentage of revenue and approximate **36%** of revenues for the full year.

We ended the quarter with **\$183** million in cash and investments compared with **\$153** million at the end of Q2 last year, and with **\$51** million in inventory or **60** days, compared with **\$42** million or **58** days last year.

Now I'd like to provide you with additional detail for our Q3 and full year financial expectations. The outlook for our Home Robot business remains strong and will drive Q3 results. We anticipate Home Robot revenue to grow **12-13%** in Q3 2014 over last year due to strong growth in domestic sales, as retailers fill their shelves for the holidays. D&S revenue is expected to decline versus Q3 last year and then ramp substantially in Q4 as we fulfill orders in backlog and those we expect to receive in the third quarter. As a result of our Q3 to Q4 revenue ramp in both businesses, DII could rise temporarily into the mid-60s, before returning to more typical levels by the end of the year.

We anticipate third quarter revenue of **\$133** to **\$136** million, an increase of **8-9%** over Q3 last year, EPS of **\$0.32** to **\$0.35**, and Adjusted EBITDA of between **\$21** and **\$23** million.

For the full year, we expect revenue to be between **\$555** and **\$565** million, reflecting an increase in the low end of Home Robot revenue expectations and a decrease in our expectations for D&S. Home Robots is expected to deliver **\$505** to **\$515** million up from our prior expectations of **\$500** to **\$515** million. Defense & Security revenue for the year

is expected to be roughly **\$45** million, compared with **\$50** million, due to timing of orders.

We expect increased full-year EPS of **\$1.10** to **\$1.20**, and Adjusted EBITDA of **\$74-\$78** million or roughly **14%** of revenue.

I'll now turn the call back to Colin.

Colin

Home Robot revenue grew **15%** in the second quarter and we expect that business to deliver full year 2014 top line growth of **18-20%** and drive company growth of **14-16%**. With increased visibility in our defense business we now expect it to be down year-over-year in the third quarter before growing substantially in the fourth quarter. And we are optimistic that remote presence will continue to gain traction in the video collaboration market while further expanding into healthcare's emerging telemedicine market.

With that we'll take your questions.

Following Q&A

Colin

That concludes our second quarter 2014 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.