

iRobot Second-Quarter 2015 Conference Call

Operator:

Good day everyone and welcome to the iRobot second-quarter 2015 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, operations and performance for fiscal 2015 and the third quarter ending September 26, 2015, the growth, performance, revenue impact and prospects of our businesses including the domestic and international growth and revenue of our businesses, our expectations regarding seasonality and predictability of 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, inventory, shares outstanding and earnings per share, the impact of our continued marketing investments, the impact of our continued investments in technology, demand for our home robots, demand for our wet floor care robotics, the mix of product revenue, and the impact on operating margins, the timing and fulfillment of government contracts and orders, demand for and adoption of our Defense & Security robots and related parts and services, our plans for expansion, our introduction

and delivery of new products, including our navigating home robot, our introduction and delivery of 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 2015 earnings press release issued last evening, which is available on our website <http://investor.irobot.com/phoenix.zhtml?c=193096&p=irol-EventDetails&EventId=5168627>. 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 29, 2015 and can be accessed by dialing **630-652-3042**, access code **38036260#**.

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 2015 as well as our

outlook on the business for 2015; Alison Dean, Chief Financial Officer, will review our financial results for the second quarter of 2015; and, Colin and Alison will also provide our financial expectations for the third quarter ending September 26, 2015 and fiscal 2015. 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.

Our second quarter results exceeded our expectations. Home Robot revenue was up slightly over last year while D&S revenue more than doubled. Earnings per share were **\$0.24** and Adjusted EBITDA was **\$18** million or **12%** of revenue.

Based on our Q2 results and our outlook for the rest of 2015, we are reaffirming our full year expectations. We continue to expect 2015 revenue of **\$625** to **\$635** million, driven by Home Robot growth, EPS of between **\$1.25** and **\$1.35** and adjusted EBITDA of **\$85** to **\$90** million or roughly **14%** of revenue.

These expectations continue to reflect our confidence that Home Robot revenue will grow **11-13%** for the full year, with growth in all three regions. We expect full-year domestic revenue growth in the high teens. We expect EMEA revenue to grow mid-to-high single digits, where growth is being tempered by Russia, and APAC to grow low single digits, as the year on year decline in Japan tempers the strong growth in China.

The incremental marketing investments we discussed on the last call, in both the United States and overseas, have successfully driven demand in those markets. Promotions we ran for Mother's Day and Father's Day coupled with our new marketing campaign in the U.S. helped drive a **24%** increase in domestic revenue over Q2 last year and strong sell through at our retailers. Supplemental demand generation spending in EMEA and APAC resulted in higher sell through in Q2, and we expect replenishment orders from our distributors in the second half.

Last year we hired two consumer product company executives, our VP, Marketing from Keurig and our VP, Sales – America from Sony. They brought significant premium brand experience that has helped us maintain our market-leading position in Home Robots. We recently announced that Tim Saeger will join iRobot as SVP, Engineering. Formerly VP and GM of Home Entertainment at Bose, he was responsible for all

aspects of product and technology development, and has led teams responsible for delivering dozens of breakthrough products to the market. His expertise will not only help us continue to build upon our world-class consumer technology Home Robot organization, but also the design and development of technology and products across the company.

Now I'll take you through some of the details of the second quarter and our expectations for the rest of 2015.

In the second quarter:

- Our Home Robot business was up **3%** year over year, slightly more than expected, while;
- Our Defense & Security and Remote Presence businesses delivered results consistent with our expectations.

As a reminder, year-over-year quarterly comparisons can be difficult due to the timing of new product introductions and where we are in the distribution cycle of those products. The year-over-year comps in the second quarter were easy in the United States and difficult overseas due to the timing of sell through and sell in of the Roomba 800 respectively.

In the United States, Q2 sell through at our top five U.S. retailers increased more than **25%** over last year. Revenue in this market was up **24%** year over year driven by sales of Roomba 800.

International Home Robot revenue was down **7%** from last year.

EMEA declined roughly **5%**, due to a substantial year-over-year decline in Russia, and APAC was down 9% for the quarter. Growth in China of more than **60%** was not enough to offset the expected year-on-year decline in Japan. Trends continue to

improve slightly overseas and we expect full-year growth in all regions, with significant year-over-year growth in the fourth quarter.

Roomba 600s and 800s are driving overall revenue growth; however, we are seeing Braava doing well, especially overseas where it comprises approximately **60%** of worldwide Braava sales. In addition, the long-anticipated navigating home robot will be launched in the second half as promised. I am not going to say anything more about the product, launch timing or features but we are very excited about it and sales of the robot are included in our expectations.

Turning now to our Defense & Security business, second quarter revenue increased more than **100%** over 2014, due to the delivery of robots and spares under the Canadian contract awarded in Q3 of last year.

We continued to build upon our solid pipeline of opportunities for both the DoD and international customers. Our full year expectations remain unchanged at this point, but the timing of orders and delivery remains somewhat uncertain.

In our Remote Presence business, we have talked about our 2015 focus on building a list of referenceable accounts and simplifying the installation process. We have highlighted a number of sales and discussed that a number of companies were testing the Ava 500 in their environments. Recently there was an article about Carbonite, a Boston-based tech firm, using Ava 500 on a trial basis. The robot, which is autonomously navigating across Carbonite's 55,000-square-foot headquarters in Boston, is being used by them to connect the company's employees in Silicon Valley and Germany.

In summary:

- Our second quarter Home Robot revenue grew year over year, driven by strong performance in the United States and China markets, and is expected to grow in both domestic and overseas markets for the full year 2015;

- We will continue to invest in marketing programs to drive growth opportunities, and in key technologies that extend our market-leading position in practical robotics.

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

Alison

We delivered second quarter revenue, earnings per share and Adjusted EBITDA ahead of our expectations, primarily due to timing. Some Home Robot orders shipped earlier than originally anticipated and higher gross margins and lower operating expenses drove higher quarterly results.

Revenue of **\$149** million increased **6%** from Q2 last year. Q2 2015 revenue includes approximately **\$2.6** million of favorable return reserve adjustments compared with **\$1.2** million in the second quarter of 2014. EPS was **\$0.24** for the quarter down from **\$0.28** in Q2 last year. Q2, and first half, 2014 EPS included a **\$0.07** benefit resulting from the release of a valuation allowance relating to certain tax attributes associated with our acquisition of Evolution Robotics. Q2 Adjusted EBITDA was **\$18** million compared with **\$16** million last year.

For the first half, revenue was **\$267** million compared with **\$254** million in 2014; EPS was **\$0.44** compared with **\$0.46**; and Adjusted EBITDA was **\$31** million compared with **\$30** million last year.

Domestic Home Robot revenue was up **24%** year over year in Q2. International revenue declined in the quarter as products sold to distributors in the first quarter were sold through, supported in part by iRobot funded marketing programs. We expect to see replenishment orders begin in Q3 2015, and accelerate in the fourth quarter. In APAC, China revenue grew more than **60%** year over year but that was not enough to offset the expected decline in Japan.

Defense & Security revenue of **\$12** million in Q2 more than doubled year over year. Roughly **70%** of this quarterly revenue was from robot sales, the majority of which were delivered under the Canadian contract.

For the total company, gross margin was **47.1%** for the second quarter 2015, up more than **250** basis points from the same quarter last year due to higher gross margins in both Home Robots and D&S. The primary drivers for the increase in Home Robot margins were product mix and favorable warranty experience in EMEA. Improved year-over-year D&S margins resulted from higher quarterly revenue in that business. For the full year we expect total company gross margin to be roughly **46%**.

Q2 operating expenses were **40%** of revenue, up from **38%** in Q2 last year primarily reflecting our normal higher quarterly marketing spending and the additional overseas demand generation investments to support our distributors. Operating expense was slightly lower than anticipated as some marketing activities and legal costs associated with patent filings were moved to Q3. We have also accelerated some additional marketing expense into Q3 from Q4 to support our second half product launch and to support our growth in China. These activities should result in opex of **38-39%** of revenue in Q3 but we still expect full year opex of roughly **37%**.

We ended the quarter with **\$224** million in cash and DII of **53** days. The lower DII reflects the **26%** sequential revenue growth in Q2 compared with Q1 this year.

Now I'd like to provide you with additional detail for our Q3 financial expectations. As we have discussed in the past, it is very difficult to predict the revenue split between Q3 and Q4 each year due to the timing and shipment of Home Robot products for the holiday season and the inherent lumpiness in our D&S business. 2015 is no exception; however, we are experiencing a more dramatic split this year with an unusually heavy Q4 shipment schedule. Given that, total company revenue is expected to decline slightly in the third quarter sequentially and be flat year over year.

We expect third quarter revenue of **\$143 to \$146** million, EPS of **\$0.20 to \$0.24**, and Adjusted EBITDA of between **\$17 and \$19** million.

Home Robot revenue is expected to grow sequentially and year over year in Q3 and then substantially year over year in Q4 as it did last year. The Q3 growth will be primarily driven by the US and China, and to a lesser extent EMEA, while Japan is expecting the decline year over year. All regions are expected to deliver strong year-over-year growth in Q4, including Japan. D&S is expected to be down sequentially and year over year in Q3, with very strong growth in Q4, as we saw last year.

I'll now turn the call back to Colin.

Colin

We delivered a solid first half of 2015 and I am confident that we have the plan, the products and the team in place to deliver full year results as expected, as well as continuing to build the foundation for growth in the coming years.

With that we'll take your questions.

Following Q&A

Colin

That concludes our second quarter 2015 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.