

iRobot Third-Quarter 2014 Conference Call Script

Operator:

Good day everyone and welcome to the iRobot third-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 fourth quarter ending December 27, 2014; our expectations regarding fiscal 2014 revenue from our businesses; our expectations regarding profitability, revenue, the rate of revenue growth, Adjusted EBITDA, Adjusted EBITDA margin, operating cash flow, gross margins, operating expenses, sales and marketing expenses, research and development expenses, general and administrative expenses, operating margins, restructuring charges, stock compensation expenses, depreciation and amortization expenses, inventory levels, tax rates, shares outstanding and earnings per share; demand for and sales of our home robots; our expectations regarding international expansion and international home robot revenue; the impact of our continued investment in advertising, our brand, training and quality initiatives; the impact of our Roomba 880[®] and Scooba[®] 450 robots; demand for our remote presence robots; timing of customer adoption of our Ava[®] 500 robot; the impact of our RP-VITA robot; the features, functionality and availability of our uPoint Multi-Robot Control system; 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 Q3 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=5041609>. 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 October 29, 2014 and can be accessed by dialing **630-652-3042**, access code **35967590#**.

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the third 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 third quarter of 2014; and, Colin and Alison will also provide our financial expectations for the fourth quarter ending December 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 an outstanding third quarter. Results exceeded our expectations as a number of orders, in both Home and D&S, originally expected in Q4 were received and delivered in Q3. Home Robot revenue grew **19%**, driving third quarter total company revenue up **15%** to **\$143** million. Earnings per share were **\$0.48** and Adjusted EBITDA was **\$30** million, or **21%** of revenue.

During the third quarter we:

- We completed the 2014 geographic distribution of our highly successful Roomba 800 series robots across the United States and overseas;
- We delivered a number of Defense & Security orders and secured several new contracts, and;
- We sold **8** robots to customers including AT&T, and additional robot trials are being conducted other Fortune 500 companies to enable remote collaboration, customer service and executive management.

Based on our visibility into the fourth quarter, we are maintaining our full-year revenue expectations and **increasing** our EPS and Adjusted EBITDA expectations. We continue to expect revenue to be **\$555** to **\$565** million. We now expect EPS of between **\$1.20** and **\$1.25** and adjusted EBITDA of **\$77** to **\$80** million or roughly **14%** of revenue.

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

Quarterly Home Robot revenue growth of **19%** was driven by **31%** year-over-year growth in U.S. markets, as domestic retailers placed orders to restock following a strong sell through in Q2, and our club store customers transitioned to a next generation Roomba. Sell through at our top five domestic retailers increased more than **30%** over last year and Roomba 800 sales across all regions comprised **36%** of Q3 revenue. We

expect to see strong sales continue in the fourth quarter as the retailers replenish their stock for the holidays to meet consumer demand.

Overseas, we launched the Roomba 800 in China, which was the last region scheduled for 2014 distribution. International Home Robot revenues grew **13%** year-over-year in the third quarter as distributors sold through Roomba 800 product introduced in Q2. EMEA grew approximately **7%** in Q3 and APAC growth of **19%** year-over-year was driven by strong demand in China. In Q4 we also expect strong growth overseas as distributors replenish following sell through in Q3 and prepare for the holiday season.

Last quarter we commented on our commitment to better articulate the value proposition of Scooba and Braava, our wet floor care products. While our 2014 marketing campaigns are set, our plans for 2015 will include advertising to promote wet floor care as well as training of in store personnel to build awareness about the products. There is a significant opportunity for this segment of the market, and we own it. In 2015, we expect revenue for wet floor care to grow as a percentage of total Home Robot revenue along with continued strong growth in Roomba sales.

In the third quarter two consumer product company executives, from Keurig and Sony, joined our Home Robot sales and marketing team. They bring significant premium brand experience that will help us maintain our market-leading position as the category becomes more competitive and our business grows.

We recently kicked off our holiday advertising campaign featuring our Roomba 800 series robot to support our retail partners throughout the 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 robot vacuum cleaner market.

Our growing success has compelled others to enter the market. In early September, Dyson announced its intention to launch a robot vacuum cleaner in Spring 2015, and this is good news. Our biggest challenge for continued strong growth is overcoming skepticism, and well-known competition entering the market will help legitimize the category and grow the industry as a whole. The world leader in traditional vacuums has declared that robot vacuum cleaners are the future of vacuum cleaning. This is an important next step towards realizing our vision of traditional vacuums becoming a thing of the past.

We have known for years that Dyson was developing a robot vacuum cleaner and because they finally unveiled a prototype, we now have the opportunity to evaluate it. We believe, they have designed around our formidable IP as their robot vacuum doesn't appear to have our patented side brush, dirt detection or debris extractors. In an effort to incorporate their cyclone suction, they created a product that is too tall to fit under most couches and beds and runs for only **20 to 30** minutes before needing to recharge. Based on press reports, it will sell for **\$1,000 to €1,000**. We think consumers will find the Roomba 800 a much better value proposition and we look forward to the head to head comparison. Dyson claims to have spent **16** years and **\$47** million on the vacuum. We spend more than that on robot R&D annually, building products developed with feedback from the millions of customers to whom we've sold Roombas over the past **12** years. We are confident in our market-leading position, and that we are making the right investments to sustain our category leadership well into the future.

Turning now to our Defense & Security business, third quarter results exceeded our expectations due to early delivery of orders we expected to fill in Q4. In addition, we finished Q3 with **\$25** million in backlog comprised primarily of upgrades for the U.S. Department of Defense fleet of PackBot robots and international orders. We are confident in meeting our full year expectations and are already building backlog for 2015. During the quarter we announced a **\$9.6** million contract to deliver iRobot 510 PackBot CBRN (Chemical, Biological, Radiological, Nuclear and Explosives) systems

and support to the Canadian Department of Defence (DND). This module, being built to the DND's specifications, includes a CBRN suite that integrates five primary sensors to reliably detect, alert and report on chemical warfare agents, toxic industrial chemicals, volatile gases, explosives and radiation. This new offering from iRobot is a great example of the versatility of our multi-mission robots.

A couple of weeks ago we announced the development of the uPoint Multi-Robot Control (MRC) system, a universal control system for iRobot's line of D&S robots, that will provide users with a powerful new touchscreen-based interface and radio communication running on Android-based tablets. The system simplifies robot operations including driving, manipulation and inspection, allowing users to focus more on the mission at hand. Its features include:

- Intuitive touchscreen technology that allows user to take on more complex tasks with less training;
- A robust radio network that offers improved communications and smart networking, the ability to automatically switch away from congested frequencies, power management, and mesh networking to form a robust network in which robots, operators, and observers work seamlessly together, and;
- Data sharing from the user's controller to other team members or remote observers

The product received positive reviews when we demonstrated it at the Army's AUSA exposition and will be available in Q2 2015. We continue to make focused investments to expand the capabilities of our existing D&S platforms. The uPoint MRC represents a major advancement in the usability and performance of ground robots and we expect it to provide another opportunity for our customers to upgrade their existing fleet of robots.

Moving on to our Remote Presence business, RP-VITA, our remote telemedicine robot, continues to slowly gain market traction. Fourteen RP-VITA robots were installed during the quarter by InTouch Health, half of them in Mexico. According to ITH, the market in Mexico is particularly attractive and that there is an opportunity to supply RP-

VITAs in each of Mexico's **31** states. Installations currently exist in **3** of those states and the utilization rates at those locations are the highest of any ITH customer. The RP-VITA operates within a hub and spoke hospital network, where there are specialists at a major hospital in each of those states providing services through the robots at more than **20** remote hospital locations. The consulting medical specialists cross multiple disciplines to provide quality diagnoses and care to patients in remote hospitals' critical care units. Patients receive care they wouldn't otherwise have access to, improving overall patient outcome. This model is being used by ITH to illustrate the RP-VITA value proposition to prospective customers.

I am also very pleased to report we sold multiple Ava 500 Video Collaboration Robots to several customers, including AT&T, where the robots are being used by executive management, to facilitate team collaboration and in a retail setting to deliver exceptional customer service experience. Additional robot trials are being conducted with a multinational law firm, manufacturing, pharmaceutical and financial services companies to enable remote collaboration, customer service and executive management. And, we look forward to future communication about them as customers.

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iRobot continues to actively use this technology. For the past year, we have been communicating with our west coast office through Ava and last quarter we installed a robot at one of our contract manufacturers' facility in China. Having our engineers communicating directly with the line has saved us both time and money and provides a compelling use case for prospective customers. We are currently in trials with several Fortune 500 manufacturing companies who are also using Ava to enable remote experts and supervisors to be "on the production line" and "factory floor".

For the rest of 2014, we will continue to focus on building a base of reference accounts and we are well on our way to doing so through additional trials with a large multinational law firm, a pharmaceutical company and a financial services firm.

In summary:

- Home Robot revenue grew **19%**, as orders expected in Q4 were filled in Q3;
- Defense & Security revenue exceeded expectations, due to order timing, and our visibility continues to improve with **\$25** million in backlog at the end of Q3, and;
- We've sold Remote Presence robots to multiple customers who are using our Ava 500 robots in a variety of different ways. Interest remains high from a number of Fortune 500 companies who are currently in trials with our robots.

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

Alison

We delivered third quarter revenue, earnings per share and Adjusted EBITDA that exceeded our expectations. Revenue of **\$143** million increased **15%** from Q3 last year driven by growth in Home Robot revenue. EPS was **\$0.48** for the quarter compared with **\$0.26** in Q3 last year. Q3 Adjusted EBITDA was **\$30** million or **21%** of revenue compared with **\$17** million or **14%** of revenue last year.

Our over-performance in the third quarter was due to fulfillment of orders in both Home and D&S during Q3 that we had originally expected to fill in Q4.

Domestic Home Robot revenue grew **31%** for the quarter as retailers began stocking their shelves for the holidays. Q3 international revenue grew **13%** over last year, driven by strong performance in China. 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 **\$11** million in Q3 was up slightly year over year and ahead of our expectations. We received and fulfilled several contracts earlier than anticipated but still expect full year revenue of **\$45** million.

For the total company, gross margin of **47%** for the third quarter 2014, was up **400** basis points from the same quarter last year. Home Robot product and customer mix were the main drivers. We now expect full year 2014 gross margin to be roughly **46%** versus the **45%** estimate we provided earlier this year.

Q3 operating expenses were **31%** of revenue, down from **35%** in Q3 last year. Keep in mind that our Q4 sales and marketing expenses will increase substantially due to the new Roomba 800 ad campaign that Colin discussed, as well as other promotional programs planned to support our retailers during the holiday season. Opex for the full year will be roughly **37%** versus our earlier expectation of **36%** as we invest our improved gross margin to maintain revenue momentum.

We ended the quarter with **\$187** million in cash and investments compared with **\$157** million at the end of Q3 last year. In April we announced a stock buyback program structured to purchase stock at clearly undervalued prices. Early in the fourth quarter, we purchased **56** thousand shares of stock under our plan for roughly **\$1.7** million, and retired them.

We ended Q3 with **\$54** million in inventory or **65** days as expected, compared with **\$49** million or **64** days last year. We expect inventories to decline in Q4 and finish at our target of roughly **60** days.

Looking now to the fourth quarter, we are expecting strong growth from both Home and D&S. Because we received orders ahead of our expectations in Q3, our Q4 ramp is not as steep as it appeared it would be in July.

We anticipate fourth quarter revenue of **\$158** to **\$167** million, an increase of **25-33%** over Q4 last year, EPS of **\$0.26** to **\$0.31**, and Adjusted EBITDA of between **\$17** and **\$20** million.

For the full year, we continue to expect revenue to be between **\$555** and **\$565** million. We are increasing our EPS and Adjusted EBITDA ranges and now expect full-year EPS of **\$1.20** to **\$1.25**, and, Adjusted EBITDA of **\$77 - \$80** million or roughly **14%** of revenue.

I'll now turn the call back to Colin.

Colin

Home Robot revenue grew **19%** in the third quarter and we expect that business to finish the year strong. Accelerated order delivery in the third quarter, coupled with increased visibility, further solidifies our confidence in our defense business

expectations. 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 third quarter 2014 earnings call. We appreciate your support and look forward to talking with you again in February of 2015 to discuss our Q4 results and outlook for 2015.

Operator

That concludes the call. Participants may now disconnect.