

## **iRobot Third-quarter 2012 Conference Call Script**

**October 23, 2012**

**Operator:**

Good day everyone and welcome to the iRobot third-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, the fourth quarter ending December 29, 2012 and full year 2013, the impact of our acquisition of Evolution Robotics and of our hiring, restructuring and strategic initiatives on financial results, our expected quarterly financial performance, the mix of total revenue and product revenue, our expectations regarding revenue growth, Adjusted EBITDA margin, cash, 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, the integration of Evolution Robotics, demand for and adoption of our Defense & Security robots and related parts and services, the impact of government program delays and the timing of government funding, the timing and volume of shipments of telemedicine 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 third quarter 2012 earnings press release issued last evening, which is available on our website <http://investor.irobot.com/phoenix.zhtml?c=193096&p=irol-eventDetails&EventId=4249338>. 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 31, 2012 and can be accessed by dialing 630-652-3042, access code 33524566#.

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 2012, our business outlook for the rest of 2012, and the preliminary revenue expectations for 2013; and John Leahy, Chief Financial Officer, will review our financial results for the third quarter and provide our financial expectations for the full year 2012 and the fourth quarter ending December 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.

Last night we reported total revenue of **\$126** million for the third quarter driven by impressive growth in our Home Robot business. Earnings per share of **\$0.54** and Adjusted EBITDA of **\$29** million for the quarter, both far exceeded our expectations. During the quarter there were a number of adjustments, the positive net impact of which was **\$7.7** million in revenue, **\$0.10** in EPS, and **\$5.2** million in Adjusted EBITDA. John will provide additional details.

Our Home Robot business unit had an outstanding quarter. Total Home Robot revenue increased **33%** year over year fueled by strong growth in both international and domestic markets.

Our Defense & Security business unit had its best performance of the year delivering revenue of **\$30** million. U.S. government funding and program delays, however, continue to negatively impact our near term expectations for this business unit.

With Home Robots accounting for more than **80%** of the company's total revenue, iRobot's financial performance will be driven by growth in the consumer business and less impacted by the ups and downs in the defense business.

During the third quarter we made a number of moves which we expect will extend our market-leading position. We announced an acquisition in support of our Home Robots business unit, hired key senior leaders across the organization, and began to implement significant strategic initiatives in our D&S business. Each of these actions will have a financial impact on Q4 and full year 2012 results as well as on 2013 results. We have revised our full year 2012 expectations to reflect these actions and now anticipate full year 2012 revenue between **\$434** million and **\$438** million, EPS of between **\$0.44** and **\$0.50** and Adjusted EBITDA of **\$47-\$49** million.

For the fourth quarter we anticipate revenue of **\$98-\$102** million, loss per share between **(\$0.39)** and **(\$0.33)** and Adjusted EBITDA loss of **(\$4)-(\$2)** million. Both Q4 and full year expectations include the impact of Evolution Robotics, Inc., which we acquired on October 1, 2012.

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

Expanded retail distribution of our Roomba<sup>®</sup> 700 domestically fueled total Home Robot revenue growth of **33%** in the quarter. In the third quarter, our domestic revenue was up **85%** over 2011 and **39%** excluding the positive impact of a returns adjustment. Total EMEA revenue grew **33%** in Q3 and comprised almost **50%** of Home Robot revenue in the quarter. Overall, international Home Robot revenue increased **16%** year-over-year. In addition to successful expansion of the Roomba 700, we introduced our Roomba 600 robot into select worldwide markets. Revenue from the Roomba 600 and 700 comprised more than **60%** of Home Robot revenue in the third quarter. Our Home Robot business will grow between **25** and **30%** in 2012 and we expect continued growth in 2013.

On September 17, we announced the signing of a definitive agreement to acquire Evolution Robotics (ER). ER's Mint<sup>®</sup> products will expand our automated floor care offerings while we expect its technology, deployed in future iRobot products, to deliver greater customer value. I am pleased to report that we closed the transaction on October 1 and we are working to quickly integrate the business. Paolo Pirjanian, ER's former CEO and iRobot's new Chief Technology Officer, is on board and assisting in the process. Our domestic sales team is in discussions with iRobot retailers regarding the addition of Mint products to their floor care line. Our operations team is working with ER contract manufacturers and component suppliers to explore savings opportunities resulting from our combined purchasing power. Expectations for the financial impact of the acquisition remain unchanged at this point for 2012 and 2013. Underlying those

expectations are the assumptions that full integration of the acquisition will be complete by the end of 2013 and that we will achieve higher revenue growth and improved margins in 2014.

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In our Defense & Security business shipments of SUGV robots and software to upgrade the existing fleet of PackBot robots drove revenue of **\$30** million for the third quarter. However, our 2012 expectations for this business have declined further and at this point our outlook for 2013 is weaker. In order to better size the organization with our revenue we have taken several actions.

- First, our Maritime business, which operated in North Carolina as part of D&S, has had both product and research components. While we think there is a future for unmanned underwater vehicles, the product market hasn't materialized as quickly as we expected. Therefore, we closed the Raleigh-Durham office and moved the research activities to Bedford.
- And secondly, we have taken actions to reduce costs across the entire D&S organization allowing us to efficiently serve our current customer base and invest in our core products and technologies.

We will record a **\$4-5** million restructuring charge in the fourth quarter as a result of these actions.

In August, Frank Wilson joined iRobot as Senior Vice President & General Manager of D&S to lead this business unit and help map its strategic direction. To support this effort, he has reconstituted his management team. Frank, who was previously vice president of business development and mission applications for Electronic Systems at BAE Systems, has extensive experience leading a business, driving business development and transforming organizations in both favorable and declining defense budget environments. We look forward to his contributions and leadership as iRobot develops new technologies to address the growing role robots have in special operations and infantry missions.

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On the last earnings call we discussed the new RP-VITA™ telemedicine robot which was built with InTouch Health on iRobot's Ava platform. We recently hired Youssef Saleh as Vice President & General Manager to lead our Remote Presence Business Unit. Youssef comes to us with a tremendous depth of experience in new product development with a focus on telepresence. Formerly a Vice President at Polycom, he started their telepresence business and grew it into a major business unit. Youssef combines entrepreneurial and product development skills to recognize opportunities that build markets and grow revenue. He has responsibility for supporting RP-VITA while exploring adjacent remote presence market opportunities.

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During the third quarter we made several strategic decisions to strengthen our business.

- Our Home Robot business has had an outstanding year and we expect continued growth in that business as we further penetrate our markets, expand our footprint, build brand awareness and add ER's Mint® products to our family. Home Robot revenue will account for more than **80%** of total iRobot revenue in 2012 and 2013.
  - The near-term outlook for our D&S business is weak. Our unmanned ground robots have become part of the U.S. military's doctrine, however the current macro environment is limiting sales to the government. We have scaled back D&S to allow it to succeed as a business unit and not negatively impact the overall company's financial performance or our commitment to profitable growth.
  - And, we will continue to invest in Remote Presence. For the past 3 years, we have been exploring and investing in this market because of its significant potential. We are now poised to access those opportunities under Youssef's leadership.
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I will now turn the call over to John to review our third-quarter results and our Q4 and full-year expectations in more detail.

**John**

Thanks Colin.

Revenue for the third quarter was **\$126** million compared with last year's **\$120** million in revenue. Earnings per share and Adjusted EBITDA for the third quarter both exceeded our expectations. Earnings per share for the quarter were **\$0.54** compared with **\$0.50** last year, which included a **\$0.12** per share one-time tax benefit. Adjusted EBITDA for Q3 was **\$29** million up from **\$20** million.

In Q3, we adjusted our accrual rates for Home Robot product returns, resulting in a benefit to revenue and earnings. Our returns experience continues to improve as the result of our sustained investment in product quality. We also booked reserves related to slow moving D&S inventory. Revenue, EPS and Adjusted EBITDA would have been **\$118** million, **\$0.44** and **\$24** million respectively, without these adjustments.

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Home Robot unit shipments grew **24%** while revenue of **\$96** million increased approximately **33%** from a year ago. International revenue increased **16%** in the quarter to **\$63** million and comprised **66%** of Home Robot revenue. Total domestic revenues were up significantly, nearly **85%** in Q3, following a **40%** increase in Q2. Revenue grew **39%** excluding the returns adjustment. Sell-through at our top **5** domestic retailers was up **17%** year-over-year reflecting the continued impact of our advertising campaign in Q2 and expanded distribution of products launched last year.

Defense & Security revenue of **\$30** million decreased from a year ago due to both lower contract and product revenue. Defense & Security product revenue was **\$25** million in the third quarter, compared with **\$38** million last year. Product lifecycle revenue was **\$15** million. Backlog at the end of the quarter was **\$12** million.

For the total company, gross margin was **43%** for the quarter. Home Robots had a gross margin of **51%**, and **47%** without the benefit of the returns adjustment. Gross

margin in our Defense & Security business improved from last quarter due to higher revenue.

Operating expenses decreased to **25%** of revenue in Q3 compared with **35%** last quarter and **29%** last year. The sequential decline was due primarily to the timing of the advertising program we kicked off in April. The first part of this campaign occurred in Q2 and the second part is scheduled for the fourth quarter to coincide with the holiday season.

At the end of Q3, we had cash, including investments, totaling **\$190** million compared with **\$145** million last year and operating cash flow is **\$12** million on a year-to-date basis. Our Q4 ending cash balance will reflect the **\$75** million cash outlay for Evolution Robotics.

There have been a number of material adjustments in 2012.

- In Q2, we adjusted our product returns accrual which had a **\$3** million positive impact on revenue and Adjusted EBITDA, and an **\$0.08** positive impact on EPS.
- In Q3, we booked an additional product returns accrual adjustment which had an **\$8** million positive impact on revenue and Adjusted EBITDA, and an **\$0.18** positive impact on EPS; we also booked D&S inventory reserves, which had a negative impact of **\$2.5** million on Adjusted EBITDA and **\$0.08** on EPS.
- In Q4, we will be realizing the impact of the ER acquisition with a **\$4-6** million positive impact on revenue, a **\$5-6** million negative impact on Adjusted EBITDA, and an **(\$0.18)-(\$0.22)** negative impact on EPS. We will also be incurring a **\$0.09 - \$0.11** EPS impact from restructuring our D&S business.
- In 2013, we continue to expect the impact of the ER acquisition to be a **\$22 - \$24** million positive impact on revenue, a **\$2-3** million negative impact on Adjusted EBITDA, a **(\$0.22) – (\$0.26)** negative impact on EPS, and to be accretive in Q4.

Inclusive of these items, we expect Q4 revenue of **\$98-\$102** million, loss per share in the range of **(\$0.39)** to **(\$0.33)** and Adjusted EBITDA loss of **(\$4)- (\$2)** million. Our full year revenue expectations are **\$434 - \$438** million with Home Robot revenue growing

more than **25%** to **\$355 - \$360** million. We anticipate Defense & Security revenue in the range of **\$75** to **\$80** million for the full year. Our full-year expectations for EPS are **\$0.44 - \$0.50** and Adjusted EBITDA are **\$47 - \$49** million.

For 2013, our preliminary expectations are for revenue to increase **5-10%** with **\$425-\$435** million in our Home Robot business, offset by a further decline in D&S revenue to **\$45-55** million.

I'll now turn the call back to Colin.

### **Colin**

Our results in the third 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 invest in the tremendous growth opportunities for our home robots and our Ava platform while working to seamlessly integrate the ER acquisition. The current military climate is disappointing; however, the longer term drivers remain intact for our Defense & Security business.

More than **80%** of our annual revenue will be generated by our Home Robot business and we expect continued growth in that unit. We have scaled back the D&S business to ensure that it does not negatively impact our commitment to profitable growth and we will continue to invest in and pursue opportunities in our Remote Presence business unit.

With that we'll take your questions.

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### **Following Q&A**

### **Colin**

That concludes our third quarter earnings call. We appreciate your support and look forward to talking with you again in February to discuss our Q4 and full year 2012 results as well as our expectations for 2013.

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