

iRobot Third-Quarter 2015 Conference Call

Operator:

Good day everyone and welcome to the iRobot third-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 and operations for fiscal 2015 and the fourth quarter ending January 2, 2016; our expectations regarding the growth, performance, revenue impact and prospects of our businesses, including the international growth, performance and revenue of 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 980[®] robot; demand for our remote presence robots; 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; the impact of our continued investment in new technology; our introduction and delivery of new products, including our Roomba 980[®] robot; our introduction 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 Q3 2015 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 October 28, 2015 and can be accessed by dialing **630-652-3042**, access code **38036803#**.

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 2015 as well as our outlook on the business for the remainder of 2015; Alison Dean, Chief Financial Officer, will review our financial results for the third quarter of 2015; and, Colin and Alison will also provide our financial expectations for the fourth quarter ending January 2, 2016 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.

Last evening, we reported revenue in line with, and earnings exceeding, our expectations for the third quarter.

During Q3:

- We successfully launched our first connected Roomba, the 980, on our website and have subsequently begun shipping it into U.S. retail and overseas markets;
- We received and fulfilled multiple Defense & Security orders and announced two significant new IDIQ contracts, and;
- We sold **6** Ava 500 robots, and **13** RP-VITA robots.

Q3 revenue met our expectations due to continued strong growth in the United States and China, partially offset by softness in Japan. Third quarter earnings exceeded expectations primarily because we decided to curtail the planned incremental Japan marketing investment, as the overall economic climate in the region was dampening its impact. Although we expect continued strong growth in the US and China, we are revising our full-year revenue expectations to **\$610** to **\$615** million, due to a slower than expected recovery in Japan and our continued caution in a few other international markets.

We are increasing our full year expectations for EPS and Adjusted EBITDA, as we have reduced our spending plans for Q4 in order to offset the lower revenue. We will also be recording a gain on investment of **\$0.06** per share, or **\$3** million in pre-tax income, from the sale of an investment we made several years ago, that was not previously contemplated in our expectations. We now expect full-year earnings per share of **\$1.35** to **\$1.40** and Adjusted EBITDA of **\$89** to **\$91** million. These expectations continue to reflect our confidence that domestic Home Robot revenue will grow in the high teens for the full year, China more than **70%**, and that most European markets will also show significant growth.

While we are experiencing weakness in a few, isolated international markets, we expect the macro impact to be temporary. Global spending on robotic vacuum cleaners continues to grow and we are maintaining our leadership position in the market despite several recent entrants in the category. We remain optimistic about the industry and our growth prospects in the coming years. Isolated challenges in Japan and Russia are the 2015 weak spots in an otherwise healthy and growing global business.

Now I'll take you through some other highlights of the third quarter and our outlook for the rest of 2015.

On September 16 we launched the Roomba® 980, our first connected home robot with navigating and mapping capabilities. The reaction we have received has been tremendous, exceeding our expectations. The Roomba 980 is the first iRobot product to incorporate the VSLAM technology we acquired as part of acquisition of Evolution Robotics. This flagship Roomba is our first step into the Internet of Things, enabling new functionality today, such as remote app-control and systematic navigation, as well as paving the way for new products and capabilities in the future. We are also collecting insightful usage data from the product which can inform future investments. We look forward to discussing our strategies to take advantage of these advances in other forums in coming months.

The 980 was available exclusively on our website in mid-September. It is now available in select retail locations in the U.S. and in Japan, and in early November it will be on the shelves in several European markets. Our distribution plan for this product is consistent with our new product launch strategy and we will roll it out globally over the next **12** months.

Strong third quarter sales in the U.S., fueled in part by the introduction of the Roomba 980, are expected to continue throughout the fourth quarter. Domestic revenue growth of **23%** in Q3 year-over-year demonstrates that we know how to profitably drive revenue

through sales & marketing investment in the U.S market. Full year 2015 domestic growth is expected to be in the high teens over last year.

EMEA revenue was flat year-over-year in Q3 and, based on our current outlook, expected to grow in the low single digits for the full year. We are continuing to see growth in most of the western European markets where we've been established for the past six years. The worsening economic situation in Russia over the past year has driven a precipitous revenue decline in a previously fast growing market for Roomba.

Revenue in APAC was down **20%** in the third quarter, due to lower year-over-year sales in Japan, but is expected to grow substantially in the fourth quarter driven by China and, to a lesser extent, Japan. In China, there are two major cyber holidays in Q4, plus distributor and retailer purchasing in advance of Chinese New Year in early February which we expect to drive fourth quarter growth of more than **100%** over 2014. While the outlook for China continues to be very strong, APAC is only expected to grow in the low single digits for the full year due to the dampening effect of Japan's contraction.

Turning now to our Defense & Security business, third quarter results slightly exceeded our expectations due to early delivery of orders we expected to fill in Q4. Seventy-five percent of D&S Q3 revenue was recognized for orders received and fulfilled within the quarter. In addition, we finished the third quarter with **\$28** million in backlog and since then, have increased it to **\$36** million. These orders are for SUGV, PackBot and Firstlook systems and upgrades as well as spares across all product lines. The majority of these orders is scheduled for Q4 delivery, giving us improved visibility into the fourth quarter.

During the quarter we announced two IDIQ contracts with a potential value of **\$96** million from the U.S. Navy. These contracts demonstrate the DoD's ongoing interest in keeping its fleet of iRobot unmanned ground vehicles equipped with the latest in robotic technologies.

Moving on to our Remote Presence business, Cisco continues to demonstrate its commitment to our partnership with the recent purchase of 4 Ava 500 robots and a purchase order for an additional 7. Their plans are to deploy them in multiple locations to connect their executives around the globe.

We continue to make progress on building referenceable accounts as well as the development of a next generation platform.

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 that met our expectations and earnings per share and Adjusted EBITDA that exceeded our expectations. Revenue of **\$144** million was flat from Q3 last year, as expected, due to lower year-over-year Defense & Security revenue. EPS was **\$0.42** for the quarter compared with **\$0.48** in Q3 last year. Q3 Adjusted EBITDA was **\$26** million or **18%** of revenue compared with **\$30** million or **21%** of revenue last year.

Our profitability in the third quarter was better than expected primarily due to our decision to curtail sales & marketing spending in Japan, as well as gross margin favorability driven by lower EMEA warranty expense and product mix in Home Robots.

Domestic Home Robot revenue grew **23%** for the quarter as retailers began stocking their shelves for the holidays and we continue to expect high teen revenue growth in domestic markets for the full year. Q3 international revenue decreased **7%** from last year, a little more than we expected, due to the weakness in Japan and Russia. The overseas outlook has deteriorated since our last call and we now expect total international growth in the low single digits over last year, despite strong growth rates in China and most European countries.

Defense & Security revenue of **\$6** million in Q3 was down from **\$11** million last year but slightly ahead of our quarterly expectations. We received and fulfilled several orders earlier than anticipated and currently have **\$36** million of backlog to support the significant ramp to **\$30** million in Q4. We expect **\$55** million in revenue for the year, **20%** growth over 2014, and to exit the year well positioned for 2016.

For the total company, gross margin of **49%** for the third quarter 2015, was up **130** basis points from the same quarter last year due to higher Home Robot gross margin driven by favorable warranty and product mix. In the fourth quarter, we expect gross margin to decline slightly due to customer mix and product mix.

Q3 operating expenses were **36%** of revenue, compared with **32%** in Q3 last year. The increase year on year primarily reflects costs associated with the launch of the new Roomba 980. The Q3 operating expense was lower than we originally planned though as we reduced our scheduled incremental Japan marketing spend.

We ended the quarter with **\$212** million in cash and investments compared with **\$187** million at the end of Q3 last year. During the quarter, we purchased **\$20** million of stock under our current repurchase plan, bringing our year to date total through the third quarter to **\$25** million. Year to date total includes shares purchased in Q1 under our previous plan as well as the shares purchased in Q3. All purchased shares have been retired.

We ended Q3 with **\$59** million in inventory or **73** days as we built inventory to support the Roomba 980 launch and our overall fourth quarter ramp. This compares to **\$54** million or **65** days last year. Inventories will return to more normal levels by year end.

Looking now to the fourth quarter, we are expecting strong growth from both Home Robots and D&S.

We anticipate fourth quarter revenue of **\$200** to **\$205** million, down from our previous expectations, but a record quarter, growing **26-29%** over Q4 last year. Due to our actions to reduce some non-revenue generating spend, combined with a **\$3** million pre-tax or **\$0.06** per share gain on investment we will record in October, from the sale of a company in which we invested several years ago, we are increasing Q4 EPS to **\$0.53** to **\$0.58**, and Adjusted EBITDA to between **\$32** and **\$34** million.

For the full year, we expect revenue to be between **\$610** and **\$615** million, EPS of **\$1.35** to **\$1.40** and Adjusted EBITDA of **\$89 - \$91** million, **14%** of revenue and a **12%** increase year-on-year.

I'll now turn the call back to Colin.

Colin

Home Robot revenue growth continues to be strong in the U.S. and China and many European countries. While we are experiencing weakness in a few, isolated international markets, we expect the macro impact to be temporary. We remain optimistic about the industry and our growth prospects in the coming years.

As we look to 2016, I am highly confident that our revenue growth will accelerate over our 2015 results. We will be rolling out our new 980 robot globally, extending our successful U.S. sales & marketing strategy to select overseas markets and investing to better position and grow our Home Robot wet floor care products.

With that we'll take your questions.