iRobot Third-Quarter 2011 Conference Call Script

October 24, 2011

Operator:

Good day everyone and welcome to the iRobot third-quarter 2011 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 the fourth quarter and full year ending December 31, 2011, our expected financial performance, seasonality, the timing of expenses, orders and order fulfillment, our expectations regarding revenue growth, Adjusted EBITDA, operating cash flow, operating expenses, gross margins, restructuring charges and earnings per share, demand for our home robots, the timing and fulfillment of government contracts and orders, demand for, adoption and backlog of our Government and Industrial robots and related parts and services, orders for our PackBot and SUGV robots, product lifecycle and recurring revenue, international home robot revenue, mix of product revenue and impact on operating margins, our plans for expansion, our introduction and delivery of new products and new product capabilities and functionality, the availability, capabilities and functionality of 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 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 third quarter 2011 earnings press release issued last evening, which is available on our website http://investor.irobot.com/phoenix.zhtml?c=193096&p=irol-irhome. 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 November 2, 2011 and can be accessed by dialing **617-801-6888**, access code **71428742**.

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 2011 as well as our outlook on the business for the rest of 2011; and John Leahy, Chief Financial Officer, will review our financial results for the third quarter and provide our outlook for financial expectations for the fourth quarter ending December 31, 2011 and fiscal 2011. 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 third quarter results were excellent across all measures. Revenue was up **28%** from Q3 last year and Adjusted EBITDA for the quarter increased **76%** to **$20** million, far exceeding our expectations. EPS grew **85%** to **$0.50** from **$0.27.** Excluding one-time tax benefits, EPS more than doubled in Q3 over last year. John will discuss the details of the tax benefit later in the call.

Due to strong performance by both divisions in the third quarter and our expectations for the fourth quarter, we are increasing our full year 2011 expectations for the second time this year. Our home robot business is exceeding our expectations while the government business is on track to deliver on the 2011 expectations we shared in February. We now expect full year 2011 revenue of between **$465** and **$470** million, an increase of roughly **17%** over 2010, full year EPS in the range of **$1.32** to **$1.36** and full year 2011 Adjusted EBITDA of **$67** to **$69** million**,** an improvement of about **40%** year over year**.** EPS includes the one-time tax benefit of **$0.12** in Q3**.**

We are increasing our expectations while also increasing our investment in research & development and marketing programs, critical to maintaining our industry-leading position.

Based on our current view of future defense spending, we have made a difficult decision to implement a reduction in force (RIF) in the government division during the fourth quarter. A decrease in our 2012 externally funded research and development efforts underlies this action. The reduction is limited to our Government and Industrial Robots division, which currently comprises approximately **40%** of our annual revenue, and will not impact our Home Robot division. This action is expected to result in a non-recurring fourth quarter restructuring charge of approximately **$1** million.

Our fourth quarter and full year 2011 financial expectations include this charge which is expected to impact EPS by approximately **$0.02 -$0.03**.

Now, I’d like to take you through some of the highlights of the third quarter.

On the home robots front, revenues increased **32%** in Q3 year-over-year and are up **27%** year to date. Strong demand for our Roomba 500 robots fueled Home Robot growth in Q3. Sales of both our new Roomba 700 and Scooba 230 robots, which were only available on our website through the third quarter, continued to exceed our expectations. Near the end of the quarter, we began shipping our Roomba 700 series to select retailers in the United States, and to several international customers for limited distribution in overseas markets. I was in Japan several weeks ago to introduce the new Roomba 700. Our launch attracted more than **150** reporters and the response from the Japanese retailers with whom I met was overwhelmingly positive.

International home robot revenue increased **56%** in Q3 year-over-year as demand in overseas markets continued to be strong. In meetings with our European partners, they commented that market growth for Roomba is outpacing the impact of a weakening economy. We are benefitting from the fact that our target customer, who we call the “modern professional,” is not being as severely impacted by economic conditions. However, we are closely monitoring indicators for signs of weakness in this market. We expect to see continued growth in the fourth quarter as the Roomba 700 robot hits select retail stores.

Domestic home robot revenue is up **10%** year to date and U.S. retailers are cautiously optimistic about the holiday season despite the macros. The fourth quarter is historically our strongest domestic quarter and we expect to see year over year growth in 2011 as well. Our initiative to improve domestic profit margins through strategic management of channel, customer, and product mix, helped deliver a **500** basis point improvement in home robot gross margins to **45%** in Q3. We are committed to our strategy of profitable growth by continuing to focus on higher-end products and exploring attractive new channels.

Our outlook for home robots is very positive and I am confident that we'll continue to see strong growth driven by our international customers, improvement in domestic consumer spending, and expansion of new product distribution.

Our Government & Industrial Robots division's revenue grew more than **20%** in Q3, over the same quarter last year, as we began fulfilling orders received early in the quarter. We are on track to deliver the 2011 expectations we shared in February.

Last quarter I provided you with our expectations for awards of both PackBot and SUGV IDIQs as well as delivery orders that we anticipated receiving prior to the end of the U.S. government's fiscal year on September 30th. We received and announced **all** of those contracts during the quarter. To recap, we received:

- A 5 year **$60M** IDIQ contract from the Army for up to **300** PackBots, which will allow the army to buy PackBots, spare parts and repair services primarily to support Foreign Military Sales. We received a delivery order for approximately **$1M** under this contract;
- A 2 year **$51M** IDIQ contract from the U.S. Army for up to 350 SUGV 310s and an initial **$11M** delivery order for **70** units; and,
- A **$21M** delivery order under our existing **$230M** IDIQ from Navsea for **100** PackBots.
- In addition, we have begun building **76** SUGVs for the Brigade Combat Team Modernization (BCTM) Low Rate Initial Production initiative, under an "authorization to proceed" from Boeing, and,
- Our small FirstLook "throwable" reconnaissance robot, is being considered by the Department of Defense to meet the needs of a Joint Urgent Operational Needs Statement for an ultra-light recon robot capable of supporting dismounted operations.

All of this is very good news and speaks to the ongoing demand by the federal Government for cost-effective products that enable improved mission efficiency while keeping warfighters out of harm's way. Our robots are part of the future.

During the quarter we also announced the partial termination of the BCTM contract by Boeing. This termination impacted only the development work we were doing under the contract which we stopped as of September 30, 2011, and not the aforementioned LRIP. There continues to be very strong demand for this product from the soldiers in theater and support from the military leadership, therefore we are working with the Government on a bridge contract that would reinstate the development work until a new contract vehicle is awarded in 2012. This action will have a nominal impact on 2011 revenue.

We have estimated the addressable market for SUGVs to be approximately **15,000** robots over the next 5-7 years. The U.S. Army has a written requirement for the purchase of **8,200** SUGVs and the balance of the opportunity is comprised of our estimate of the potential demand from other branches of the armed services, as well as first defenders and international customers. The timing and form of the contracting vehicle, or vehicles, to procure the SUGVs are uncertain given the current situation in Washington.

Going into 2012, we expect the federal Government to be operating under a continuing resolution and that the defense budget will be cut further following completion of work by the joint select committee on deficit reduction. Our decision to implement a reduction in force was driven primarily by a cutback in external R&D funding from the Government in 2012, which we expect will directly impact our G&I contract revenue next year. That said, we believe that current demand for our products and technology and the fact that we represent the future of the modern military position us well within the defense contractor community.

The inherent lumpiness in our G&I business has been exacerbated this year by competing budget priorities in Washington resulting from the state of the U.S. economy. The delayed passage of the 2011 budget resulted in lower year over year growth for our G&I division in 2011 and we expect a similar challenge in 2012.

In summary, our home robot business is exceeding our expectations while our government business is on plan to deliver 2011 expectations. Because of our confidence in delivering more profitable results than we discussed in July, we are increasing our expectations for the full year.

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

John

Thanks Colin.

Our performance in the third quarter was very strong. Revenue, earnings per share and Adjusted EBITDA all exceeded expectations. Revenue was **$120** million for the third quarter, an all-time high for this period and we are on track to deliver another record year. Growth in our international Home Robot business continued to show strength despite global macro issues. Our Government & Industrial Robot business grew more than **20%** in the quarter, consistent with the expectations we've discussed on previous earnings calls this year.

Earnings per share for the quarter were **$0.50** compared with **$0.27** in Q3 last year, up **85%** from last year. Excluding the impact of a **$3.5** million tax benefit in 2011, and the **$2.3** million one-time benefit recorded in 2010, EPS for the quarter would have been **$0.38**, compared with **$0.18** last year**.** Adjusted EBITDA for Q3 increased more than **75%** to **$20** million and year to date Adjusted EBITDA has grown **37%.** Importantly, Adjusted EBITDA reached 17% of revenue, our highest level ever, during the quarter.

Operating cash flow was very strong at **$25** million in Q3 and **$19** million year to date due to record net income and reduced inventory levels. Our cash and investments totaled **$145** million, up **$38** million from Q3 last year. Our return on invested capital, or ROIC, is now in the high teens. Our cash and ROIC are the highest in the company's history.

In the Home Robot division, revenue of **$72** million increased **32%** from a year ago. International revenue increased **56%** in the quarter year over year and comprised **75%** of Home Robot revenue. While domestic revenue was down **10%** in Q3 due to timing of shipments, we expect that market to rebound in Q4. Home Robot gross margins improved **500** basis points, primarily due to product and channel mix.

In the G&I Division, revenue was **$48** million compared with **$40** million a year ago. Product lifecycle revenue was **$12** million or **32%** of G&I product revenue. As anticipated, we made significant shipments of PLR in the third quarter and expect to do so again in Q4, which will result in full year PLR equal to **25 – 30%** of G&I product revenue.

Product backlog at the end of the quarter was **$28** million.

For the total company, gross margin for the quarter was **42%** compared with **35%** last year, up more than **600** basis points. The year over year increase was driven primarily by favorable revenue mix in home robots and higher overhead absorption in G&I. Gross margins have improved more than **1,000** basis points from two years ago.

Operating expenses grew to **29%** of revenue from **27%** in Q3 last year. The increase was due to higher investments in iR&D which were up **45%** in Q3 and **58%** year to date. Increased spending on marketing programs, up **36%** in the quarter and **30%** year to date also contributed to higher opex. We began these initiatives in the third quarter of last year, and built the increases into our 2011 plans.

Now I'd like to provide you with additional detail for the financial expectations Colin discussed, as well as color on the balance of the year. We expect Q4 to be a strong finish to the year, with revenue growth higher than our record-breaking Q4 last year.

We expect Q4 revenue to grow more than **15%** over last year in the range of **$130** to **$135** million, EPS of **$0.26** to **$0.30** and Adjusted EBITDA of between **$16** million and **$18** million. For the full year, we expect revenue of **$465** to **$470** million, EPS of **$1.32** to **$1.36,** and Adjusted EBITDA of **$67** to **$69** million. Importantly, Adjusted EBITDA which we consider to be our key profitability metric will reach **15%** for 2011. This is a full year ahead of schedule for attaining mid-teens EBITDA margin.

For the full year, we expect Home Robot revenue to grow more than we anticipated, at roughly **21%**, to a range of **$275** to **$280** million. We expect G&I revenue to be **$190** to **$195** million, or roughly **12%** growth, in line with our previous expectations.

Fulfillment of G&I contract awards received at the end of Q3 will result in higher robot shipments in Q4 than Q3. Home robot revenue should be up slightly in Q4 over Q3 due to the holiday season, but not as significantly as it has been historically due to the non-seasonal nature of our international business.

We completed two tax initiatives during the quarter which resulted in a lower Q3 tax rate and lower actual cash taxes. We booked a cumulative benefit associated with a "Section 199 Deduction", which is available to domestic manufacturers and software developers. The second initiative involved a comprehensive true-up of R&D tax credits claimed in prior years. Our Q4 tax rate will be roughly **31%,** and **25%** for the full year due to the Q3 benefit.

As Colin indicated earlier, for the full year, we are increasing our expectations for EPS and Adjusted EBITDA. Cash from operations is expected to total **$35-38** million, in line with our goal of high single digit Operating Cash Flow margin.

Finally, as we are working on our 2012 annual operating plan and the targets underlying our 3-year financial plan, I'd like to note several things. As you have heard Colin discuss, we are expecting an overall decrease in DoD spending that will impact us at some level. Our G&I business will likely not grow at the annual rates we have seen over the past couple of years. In 2011 we felt the impact of a continuing resolution when we set divisional growth expectations at mid-teens following a year in which revenues grew nearly **30%.** The reduction in force that Colin discussed, is based on our expectation that G&I growth will slow in 2012. However, the action will result in savings that will help ensure our continued strong financial performance.

Our home robot division continues to grow in long-time and new markets through the sale of existing and new products. It currently comprises more than **60%** of the company's revenue and we expect it will drive iRobot's growth over the next several years as the government sorts through its budget issues.

I'll now turn the call back to Colin.

Colin

Our results for the third quarter exceeded our expectations:

- Our international home robot business continues to perform well in long-term markets as it lays the groundwork in new markets;
- Our two new home robot products continue to sell well on our website and retailers are very excited about having them for the holiday season;
- We received and announced all of the government contracts we anticipated which will enable us to meet our increased expectations; and,
- iR&D funding is up **58%** year to date demonstrating our continuing commitment to investing in our future.

Finally, I'd like to leave you with a few thoughts about how I see the company and our vast opportunities. iRobot is the leader in providing remote presence and automated home maintenance solutions and we are committed to continue making the technology investments required to maintain our leadership position for years to come. Both the Roomba and PackBot, our flagship products, have been sold around the world for 9 years and we are currently producing the 6th generation of Roomba.

We have significant runway with our core home robot products as current market penetration is still less than **10%.** Beyond our core are many potential products to further automate the home, inside and outside, that we could bring to market through internal development or acquisition.

We have built bigger and small versions of our PackBot platform, the Warrior and FirstLook robots, in response to the developing needs of our military customer. Our technology is enabling increased autonomy to improve the tempo of operation and effectiveness of the warfighter. And through continued development, our robots will reduce the cost of conflict through force multiplication.

Importantly, we have exceeded our core 3-year financial goals for revenue growth, Adjusted EBITDA margin, and operating cash flow.

Today iRobot is truly a global technology company with a portfolio of products meeting the needs of customers worldwide and our exceptional results reflect the increasing diversification of the company. We are successfully meeting the challenges of international economic uncertainty, and continuing unresolved U.S. budget issues by delivering multiple products into multi-billion dollar automated home maintenance and remote presence global markets.

With that we'll take your questions.