

iRobot Fourth-Quarter and Full Year 2014 Conference Call Script

Operator:

Good day everyone and welcome to the iRobot fourth-quarter and full year 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, operations and performance for fiscal 2015 and the first quarter ending March 28, 2015, the growth and revenue impact of our businesses including the international growth and revenue of our businesses, our expectations regarding the 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, operating expenses, gross margins, operating margins, restructuring charges, stock compensation expenses, depreciation and amortization expenses, tax rates, shares outstanding and earnings per share, the impact of our continued investment in quality and improved operational performance, the impact of our continued investment in expanding the robotic vacuum cleaner category and our customer base, demand for our home robots including our Roomba[®] 800 and Roomba[®] 600 robots, demand for wet floor care robots including our Scooba[®] robot, mix of product revenue and impact of operating margins, , the timing and fulfillment of government contracts and orders, demand for and adoption of our Defense and Security robots and related parts and services, orders for and sales

and deliveries of our PackBot[®], SUGV and FirstLook[®] robots, our Defense and Security contract, product lifecycle and recurring revenue, 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, including navigation technology, and the impact of our related investments in development of 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 Q4 and full year 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=5168619>.

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 February 12, 2015 and can be accessed by dialing **630-652-3042**, access code **38036844#**.

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the fourth quarter and full year 2014 as well as our outlook on the business for 2015; Alison Dean, Chief Financial Officer, will review our financial results for the fourth quarter and full year 2014; and, Colin and Alison will also provide our financial expectations for the first quarter ending March 28, 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.

2014 was another great year for iRobot. Last evening, we reported Q4 and full year results in line with our expectations. Home Robot revenue grew **19%**, driving full-year 2014 company revenue up **14%** to **\$557** million. Earnings per share were **\$1.25**. Adjusted EBITDA was **\$80** million or **14%** of revenue. All three of our businesses met our expectations and made progress against their strategic plans, setting us up well for 2015.

In 2015 our financial performance will continue to be driven by our Home Robot business. Home Robot revenue is expected to grow **10 - 12%** in 2015 and comprise **90%** of total company revenue. We anticipate Defense & Security will grow for the first time since 2011, and our Remote Presence business will focus on improving the scalability of our solution while holding revenue flat at 2014 levels.

For 2015, we expect revenue of **\$625** to **\$635** million; EPS of **\$1.25** to **\$1.45** and adjusted EBITDA of **\$85** to **\$95** million. Additionally 2015 will be an important year for iRobot as we begin to rollout and monetize investments we have been making in crucial robotic technology.

Now I'll take you through some of the details of 2014 and our expectations for 2015.

- Our Home Robot business had another outstanding year. Revenue grew **19%** for the full year over 2013, and comprised **91%** of the company's total revenue for the year;
- Our Defense & Security business delivered results consistent with our expectations, exited the year with a solid backlog, and is positioned for healthy growth in 2015, and;
- Our Remote Presence business continued to ramp sales of telemedicine robots to our partner InTouch Health for use in hospitals, and Ava[®] 500 Video Collaboration robots to several Fortune 500 customers.

Full year Home Robot revenues were driven by strong growth in both domestic and international markets. Expanded distribution of Roomba 800 worldwide, growth in China and the launch of higher ASP Roomba 600 robots in club stores were the primary drivers. Roomba 800 and 600 each comprised roughly **30%** of total home robot revenues.

Our continued investment in marketing programs to generate greater brand awareness helped drive full year domestic revenue growth of more than **20%** over last year. Likewise, our commitment to improving product quality and ease of use resulted in a reduction to our product returns accrual that positively impacted revenue and profit for the year. Higher quality robots and improved operational performance coupled with a premium ad campaign have proven to be a successful formula. We will continue to invest in these and other initiatives that expand our competitive moat and secure our market-leading position.

Our 2014 international Home Robot revenues grew **17%** year-over-year driven by a return to growth in EMEA following a decline in 2013. Revenue in EMEA grew **18%** over last year. In APAC, we continued to see strong demand in China, where revenue more than doubled in 2014 over 2013. Macros in Japan weighed heavily on consumer spending in Q4 and resulted in a slight decline in Japanese revenue year over year. Overall, APAC grew **13%** in 2014. APAC and EMEA each comprised roughly **30%** of 2014 Home Robot revenue.

In 2015, the products expected to fuel growth are the Roomba 600 as club stores complete the transition to the next generation Roomba, and the Roomba 800 in worldwide distribution for the full year.

Our research shows that we are still in the early stage of adoption, both domestically and internationally, for the robotic vacuum cleaner category. We believe that as awareness of the category continues to expand, we could see an adoption rate similar

to other disruptive household appliances such as the microwave oven and dishwasher. It is our intent to focus our investments on growing the category and extending our customer base.

Wet floor care continues to be an important part of our strategy and we are working to optimize the positioning and go-to-market strategy of Scooba and Braava.

In 2015, we expect strong Home Robot revenue growth in the mid teens in the United States while overseas growth will be tempered by macros and currency devaluations. Because we sell our products to distributors in dollars, we aren't directly impacted by currency fluctuations. During a period of prolonged currency devaluation, as is currently being experienced in Europe and Japan, there is pressure on pricing and the distributors' ability to invest in marketing, which further impacts revenue growth.

In EMEA, the macros will temper growth in 2015. Japan, however, is experiencing a perfect storm of a recessionary economy and a significantly devalued currency. Japan is our largest market outside the United States, and while we continue to hold our market share, the negative impact on 2015 revenue will likely not be offset by growth in China.

For the past couple of years we have talked about the opportunity for China to become iRobot's largest non-U.S. customer. We saw significant growth in 2014 and expect it to continue in 2015 and beyond. To ensure that we capitalize long term on this huge opportunity we will continue to balance growth with requisite controls in this market.

While current macros are presenting a challenging backdrop for 2015, we are excited that on a global basis this business is still growing significantly. Since 2008, we have successfully built a global business, in a nascent industry, while weathering challenging economic times around the world. I am confident that we have the products and pipeline to continue this growth for the foreseeable future.

Turning now to our Defense & Security business, full year results were in line with our overall expectations. Roughly **60%** of revenue was product lifecycle revenue and **33%** was robot sales, primarily PackBot and FirstLook robots. The remaining **7%** was from externally funded R&D. International revenue increased to roughly **40%** of full year D&S revenue from approximately **30%** in 2013, while the DoD comprised **48%** of total 2014 revenues compared with **60%** in 2013.

We expect **20-30%** D&S revenue growth in 2015 driven by international and continued traction from DoD upgrades, however longer term visibility into DoD robotic investment remains poor. Our **\$18** million backlog exiting 2014 was twice the size of last year's backlog. In 2015, we will continue to focus on the international market as well as continuing to sell spares, service and support for the worldwide installed base of more than 5,000 iRobot unmanned ground vehicles.

Moving on to our Remote Presence business, RP-VITA, our remote telemedicine robot, continues to gain market traction. Last quarter we discussed how InTouch Health is selling the RP-VITA to hub and spoke hospital networks, where there are specialists in a major hospital providing services through the robots at remote hospital locations. Providing consistently high quality care on a timely basis over a telehealth network will improve the quality of care while reducing overall costs. This is the model ITH will continue to use in 2015 to articulate the RP-VITA value proposition to prospective customers.

In 2014, we began shipping our second mobile telepresence robot, Ava 500, in partnership with Cisco. Interest and excitement about this product continue to build. Ava was recently featured in Intel's keynote at the Consumer Electronics Show and our relationship with Cisco continues to strengthen. Our primary focus for Ava in 2015 will be scalability as we actively work with customers to shorten the sales cycle and simplify the implementation process. Over the past year of working with our current customers and those still in trials, we have learned a great deal about the challenges of creating a new market. Based on the multiple ways in which we are using the product, to facilitate

remote collaboration in our offices and on our manufacturing floors, and the various uses of our customers, we are confident that we can both create and grow a market for our mobile telepresence robots.

Revenue for 2015 is expected to be relatively flat at **\$3** million, two-thirds of which we expect to come from sales of RP-VITA and the other third from Ava 500. Getting the formula right with complex new robot technology products is challenging but we believe we have the right technology, partners and customer base to be successful.

In 2014, we began talking more about our leadership in the development of robots with the capability to build maps and use them to precisely navigate around the environments in which they operate. In 2015, we will begin to further monetize our navigation technologies, through:

- Visual Simultaneous Location and Mapping or vSLAM, with the incorporation of the next generation of navigation technology more broadly to include our Home products;
- uPoint™ capabilities on our defense robots, and;
- Optimization of Ava's mapping technology through scalability.

Over the next year, we expect this mapping capability, coupled with internet connectivity, to move us from a leader in the robotic vacuum cleaner market, to a technology company developing navigating, connected devices for the home. It is our intent to continue investing in this critical technology and the economic opportunities it unlocks.

In summary, 2014 was a very successful year.

In 2015:

- Home Robot revenue will continue to grow in domestic markets at roughly **15%** and comprise approximately **90%** of total company revenue;

- We will continue to invest in marketing programs and ongoing quality initiatives that drive profitable Home Robot growth;
- We will continue to pursue defense opportunities overseas while upgrading the DoD's fleet of robots;
- We will focus on scalability of our remote presence business, and;
- We will continue to invest in key technologies that extend our market-leading position in practical robotics.

I will now turn the call over to Alison to review our fourth quarter and full year results in more detail.

Alison

Our fourth quarter revenue, earnings per share and Adjusted EBITDA were in-line with our expectations. Revenue of **\$159** million increased **26%** from Q4 last year driven by growth in Home Robot revenue. EPS was **\$0.31** for the quarter, which included a **\$0.04** positive impact from an investment tax credit, compared with **\$0.11** for the same period last year. Q4 Adjusted EBITDA was **\$20** million compared with **\$13** million last year.

Domestic Home Robot revenue growth was **21%** for Q4 and **22%** for the year, further evidence that our advertising investments, product and channel strategies and quality initiatives are yielding positive results. Q4 domestic revenue was partially impacted by a favorable adjustment to the product return accrual of **\$1.0** million. This compares with a **\$4.5** million favorable adjustment in 2013. We have seen favorable adjustments on and off over the last few years as we have seen our return rates declining. International revenue grew **17%** for the full year with EMEA growing **18%**, and APAC growing **13%**.

Defense & Security revenue of **\$24** million in Q4 was up **48%** year over year as expected. Roughly **65%** of this quarterly revenue was from PLR, **10%** was externally funded R&D, and the balance was from robot sales.

For the total company, gross margin was **48%** for the fourth quarter and **46%** for the full year 2014. Year over year improvement was due primarily to favorable product and customer mix in Home Robots.

Q4 operating expenses were **40%** of revenue, down from **43%** in Q4 last year. We said on our Q3 earnings call that Q4 sales and marketing expenses would increase substantially due to the Roomba 800 ad campaign, as well as other promotional programs planned to support our retailers during the holiday season. For the full year, sales and marketing was **15%** of total revenue, at a consistent level with our

expectations and the prior two years. Opex for the full year was **37%**, an improvement of **2** percentage points from last year.

EBITDA for the quarter was **\$20** million compared with **\$13** million last year; with full year 2014 results of **\$80** million or **14%**, compared with **\$62** million or **13%** last year. EPS in Q4 was **\$0.31** and **\$1.25** for the full year. Both were favorably impacted by **\$0.04** from the enactment of the 2014 investment tax credit in late December.

Q4 operating cash flow was **\$41** million resulting in full year 2014 OCF of **\$41** million, **7%** of full year revenue. We ended the year with **\$222** million in cash, up from **\$187** million a year ago. 2014 year-end inventory was **\$48** million or **53** days compared with **\$46** million or **63** days last year. The improvement in year-over-year DII was due to significantly higher Q4 Home robot revenue.

Now I'd like to provide you with additional detail and some of the underlying assumptions for our Q1 and full year 2015 financial expectations. The outlook for our Home Robot business remains strong with growth drivers identified for the next couple of years. For the Defense & Security business, our visibility is again limited in 2015. We, however, expect our continued focus on international and DoD PLR to result in revenue growth of **20-30%** over 2014. We expect Remote Presence revenue to remain flat in 2015 as we fine tune the product and go-to-market strategy.

We expect full year revenue of **\$625** to **\$635** million comprised of Home Robot revenue of **\$565** to **\$575** million and D&S revenue of **\$55** to **\$60** million. We anticipate revenue from Remote Presence to contribute approximately **\$3** million. As in the past two years, revenue will be more heavily weighted in the second half when we expect to deliver more than **55%** of the year's revenue. While we provide quarterly expectations, we manage our business from a full-year prospective. Keep in mind that it is difficult to predict precise order timing between quarters and especially between Q3 and Q4.

We anticipate total company Q1 2015 revenue to be flat to slightly up year-over-year to **\$114 to \$117** million, and then increase sequentially throughout 2015 as it did in 2014. Based on the current economic environment in Japan, we are expecting Q1 revenues from that market to decline in Q1 2015 from Q1 2014, which is negatively impacting total company Q1 growth.

As Colin discussed, Home Robots growth will be driven by full year distribution of the Roomba 800, growth in China and replacement of the 500 series with Roomba 600 in the club stores. Overall, we expect home robots to grow **11-13%** in 2015, fueled by strong growth in the United States.

We expect approximately half of D&S revenue to come from robot sales, and half from PLR to support the installed base of robots.

We expect Q1 EPS of **\$0.08 to \$0.10** and full-year EPS of **\$1.25 to \$1.45**. Adjusted EBITDA in Q1 is expected to be **\$10 to \$11** million and for the full-year is expected to be **\$85 to \$95** million.

Consistent with our commitment to improve profitability through opex leverage, we expect 2015 operating expenses to decrease to between **35% and 36%** of revenue for the full year down from **37%** in 2014. We expect operating cash flow to continue to run in the high single digits as a percentage of revenue.

We are also assuming:

- Gross margin of **45% - 46%**
- Stock comp expense of roughly **\$15** million;
- Depreciation and amortization expense of approximately **\$15** million; and,
- Diluted share count of approximately **31** million shares.

We are estimating a tax rate of **34%** for 2015. The high end of our EPS range assumes a nominally positive impact from an investment tax credit for 2015. I'll now turn the call back to Colin.

Colin

We expect our Home Robot business to deliver good growth in 2015 on an ever increasing base; our stable defense business to show healthy growth year over year; and remote presence to be flat year-over-year.

With that we'll take your questions.

Following Q&A

Colin

That concludes our fourth quarter and full year 2014 earnings call. We appreciate your support and look forward to talking with you again in April to discuss our Q1 results.

Operator

That concludes the call. Participants may now disconnect.