iRobot Second-Quarter 2011 Conference Call Script

July 26, 2011

Operator:

Good day everyone and welcome to the iRobot second-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 fiscal 2011 and the third quarter ending October 1, 2011, our expected financial performance, seasonality, the timing of expenses, orders and order fulfillment, our expectations regarding revenue growth, Adjusted EBITDA margin, operating cash flow, operating expenses and gross 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, backlog and demand for and adoption of our Government and Industrial robots and related parts and services, including the timing and fulfillment of government contracts and orders, international demand and mix of product revenue, orders for our PackBot and SUGV robots, product lifecycle and recurring revenue, demand for our home robots, international home robot revenue, mix of product revenue and impact on operating margins, 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 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 second 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 August 3, 2011 and can be accessed by dialing 617-801-6888, access code 35680683.

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the second 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 second quarter and provide our outlook for financial expectations for the third quarter ending October 1, 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 second quarter results exceeded our expectations for both divisions and reflect a positive trend in domestic consumer spending for our home robot products. Revenue was **$108** million for the quarter up **11%** from Q2 in 2010; EPS of **$0.29** was up **$0.09** year over year, and Adjusted EBITDA of **$16** million, or **15%** of revenue, grew **30%** from Q2 last year.

Following strong performance by both divisions in the second quarter and our expectations for continuing profitable growth, we are increasing our full year 2011 expectations. We expect full year 2011 revenue of between **$460** and **$470** million, an increase of roughly **16%** over 2010, EPS in the range of **$1.04** to **$1.10,** and Adjusted EBITDA of **$62** to **$64** million**,** an improvement of almost **30%** year over year**.**

Home robot's revenue increase was driven by higher sales in our domestic business, both retail and web-based, as well as growth internationally, particularly in Asian markets. Our Government & Industrial division's revenue exceeded our expectations for the quarter in part because we received some orders during the quarter that we anticipated in Q3. Overall G&I revenue was down slightly from last year due to delayed approval of the government's DoD budget.

On the home front, domestic revenues increased **30%** in Q2 year over year following a **12%** year-over-year increase in Q1. These back to back quarterly increases are a positive indication that the U.S. consumer is beginning to spend again, however, we remain cautious about expectations for the holiday season given the uncertain economic environment. In 2010 we executed a strategy focused on creating the right mix of products and channels in the domestic market which would enable us to improve our margins. We are now positioned to take advantage of improving domestic consumer demand and will continue to generate profitable growth.

We have been a technology company since our founding 21 years ago, but as the markets our products serve mature, customer demand for increasingly sophisticated product features enabled by more advanced technology has grown significantly, which in turn makes our technology more valuable.

At this year's analyst day in May we talked about our mission: to lead the world in providing remote presence and automated home maintenance solutions supported by technical leadership in three areas, autonomy, manipulation and platforms. To extend our leadership position, we've leveraged the mobile computing industry and gaming industry's advances and become much more focused on the key robot specific technologies – autonomy, manipulation, and platforms, where we can be sustained world leaders. That has been a very significant shift and positive move for the company, improving our competitive positioning, long term value creation and better meeting the needs of our customers.

In early May, I was out at Google, attending its developer conference, where I had the privilege of addressing 2,500 Android developers and informing them that as Android developers, they were now also robot developers. Using our prototype Ava robot, we demonstrated our technology showing how our platforms can support a tablet running Android. Our AWARE® 2 software, houses the autonomy, navigation, and motor control, and makes it possible to integrate third party developed technology onto iRobot platforms.

In addition, we recently announced that we had signed a joint development and licensing agreement with InTouch Health to explore potential opportunities for healthcare applications on iRobot platforms such as the iRobot Ava mobile robotics platform. InTouch Health, and its founder Yulun Wang, have been pioneers in both the use of robots in hospitals and various remote presence technologies. The agreement includes extensive cross-licensing of the companies' patent portfolios, giving the collaboration a formidable patent position. I expect that together we will revolutionize how people communicate and deliver information through remote presence.

Much of the technology we've developed since our founding has been funded through our work in the G&I division. Over the years we have talked about the synergies between the divisions, technology development being a critical one. Ava is the perfect example of our using technology developed in our government division and combining it with technology developed by others to create a much lower price point product. Total R&D investment has increased **45%** from 2009 to 2011 while iR&D has more than doubled.

Our strong financial performance has enabled us to provide great return for investors; and at the same time has earned us the right to make the technology investments required to maintain leadership in the areas I've discussed.

Now, I'd like to take you through some of the other highlights of the second quarter.

In Home Robots, strong demand for our Roomba 500 robots in both domestic and international markets fueled Home Robot growth in Q2. The success of our new Roomba 700 series on our website, the majority of which sold for **$600** each, drove a **32%** increase in our direct business. Sales of both our new Roomba 700 and Scooba 230 robots, exceeded our expectations. To date, these new products have only been available on our website but we will expand distribution later this year when we begin selling the new Roomba in select retailers.

Total domestic sales grew **30%** year over year, in part reflecting the impact of marketing investments we began making in Q4 2010 and continued through the first half of this year. Consistent with the program we discussed last quarter to improve domestic profit margins through more strategic placement of product in select channels, we delivered a **500** basis point improvement in home robot gross margins from **39%** in Q2 last year to **44%** in Q2 this year. We are committed to our strategy of profitable growth; continuing to focus on higher-end products and exploring new channels.

International Home Robot revenue increased **16%** year over year. Demand in Asian markets, particularly in Japan where our partner has invested extensively in Roomba video demos and retail displays, contributed to second quarter growth. Talks with our prospective Chinese distributor continue and we are on track to enter that market in 2012.

Our outlook for home robots is very positive and I am confident that we'll continue to see strong growth as sales to our international customers grow, domestic consumer spending improves, and we expand the distribution footprint of our new products.

The Government & Industrial division delivered **192** robots, an equal number of PackBot and SUGV units. For the rest of the year we expect orders of SUGVs to exceed PackBot orders which should result in a **60%/40%** split between SUGV and PackBot systems for the full year. During the quarter we announced a **$7.4** million order for SUGV 320s. This was the first order for this type of robot outside of the Brigade Combat Team Modernization (BCTM) program and the first use of these robots in theater. Prior to the end of the U.S. government's fiscal year on September 30th, we expect to be awarded IDIQs for both PackBot and SUGV robots. We also anticipate receiving delivery orders requiring fulfillment by December 31st for which we've already begun building product. The majority of these robots will be shipped in Q4.

As we discussed at analyst day, we have estimated the addressable market for SUGVs to be approximately **15,000** robots. Orders for SUGVs will begin to outpace those for PackBots in 2011 and will continue to grow as the number of new PackBot orders remains steady or declines slightly over the next couple of years. A key component and growth driver of our Government & Industrial business is product lifecycle revenue or PLR. We have sold more than **3,500** PackBots, each requiring spare parts, support, maintenance and software upgrades over their 10 year life spans and we expect ongoing orders of PLR to support the fleet.

The inherent lumpiness in our G&I business has been exacerbated this year with the delayed passage of the 2011 budget. We continue to have confidence in our ability to deliver strong second half results and meet our full year expectations based on the most recent congressional mark up of the President's proposed 2012 budget. The President's budget request for **$36** million for SUGVs has been increased by the House Defense Appropriations' committee to **$60** million. While not final, it is indicative of the value that the decision-making constituents place on our robots.

In summary, both of our businesses are performing well in uncertain environments and we expect them to continue doing so throughout 2011. Because of our confidence in delivering more profitable results than we discussed in February and April, we are increasing our expectations for the full year.

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

John

Thanks Colin.

Our performance in the second quarter and first half was outstanding, particularly given very challenging 2010 comps. Revenue, earnings per share and Adjusted EBITDA all exceeded expectations. Revenue was **$108** million and **$214** million for the second quarter and first half respectively, both all-time highs for these periods. Growth in our domestic Home Robot business showed strength due in part to our marketing investments and a very positive response to our new products. Our Government & Industrial business, though down slightly for the quarter, also exceeded our expectations.

Earnings per share for the quarter were **$0.29,** up **45%** from **$0.20** in Q2 last year, and up **27%** for the first half from a year ago. Adjusted EBITDA was **$16** million for Q2, and **15%** of revenue. Adjusted EBITDA grew **30%** in Q2 and **20%** in the first half.

Our cash and investments totaled **$123** million, up **$24** million from Q2 last year. In addition, we recently announced an increase in our revolving credit facility to **$75** million, up from **$40** million, providing further financial capacity for the company.

In the Home Robot division, shipments grew **12%** and revenue of **$64** million increased **21%** from a year ago. International revenue increased **16%** in the quarter year over year and comprised **65%** of Home Robot revenue. Total domestic revenues increased **30%** year over year, an encouraging sign that U.S. consumers are beginning to spend again. Home Robot gross margins improved **500** basis points, primarily due to product and channel mix and cost savings in our supply chain.

In the G&I Division, revenue was **$44** million compared with **$45** million a year ago. Product lifecycle revenue was **$7** million or **20%** of G&I product revenue. We expect significant shipments of PLR in the second half, generating full year PLR of **25 – 30%** of G&I product revenue.

Product backlog at the end of the quarter was **$15** million, compared with **$12** million at the end of Q2 2010.

For the total company, gross margin for the quarter was **39.4%** compared with **34.7%** last year, up almost **500** basis points. The year over year increase was driven primarily by favorable mix in both divisions.

Operating expenses grew, as expected, to **29%** of revenue this year from **26%** in Q2 last year. The increase was due to higher investments in iR&D and marketing initiatives we began in the second half of last year, and built 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 how we see the rest of the year unfolding.

For the full year, we now expect Home Robot revenue to grow more than we expected, at roughly **20%**, to a range of **$270** to **$275** million. Our G&I revenue expectations are unchanged, at **$190** to **$200** million, or roughly **15%** growth**,** reflecting delays in the 2011 DoD budget.

We expect Q3 to be another strong quarter, with revenue up roughly **25%** over last year. We anticipate revenue in the range of **$115** to **$120** million, EPS of **$0.22** to **$0.26** and Adjusted EBITDA of between **$14** million and **$16** million.

Based on the expected timing of G&I contract awards, we are likely to ship significantly more robots in Q4 than Q3, thus skewing the division's second half revenue into the fourth quarter. Home robot revenue should be up slightly in Q4 over Q3 due to the holiday season, but not as significantly as it had been historically, due to the non-seasonal nature of our international business.

We expect full year gross margins of **39-40%,** an improvement from our original expectations as a result of favorable mix management and savings in product costs realized through supply chain management in home robots, and through overhead expense leverage in G&I. Our full year tax rate also looks like it will be closer to **34%** than the **37%** we initially expected.

As Colin indicated earlier, for the full year, we are increasing our expectations for revenue, EPS and Adjusted EBITDA.

Finally, as we shared during our analyst day in May, we benchmark ourselves against a group of companies which have attributes in common with iRobot. While some of you may think of us with a defense or consumer electronics orientation, we are truly a technology company. Our peer group consists of tech companies up to **$1.5** billion in revenue with both a software and a hardware component, who are market leaders in high growth segments, and in many cases, creators of the segments in which we operate, and who enjoy large addressable markets. These peers have high margins or expanding margins and have created wide competitive moats. The combination of these attributes drives attractive valuation multiples.

At iRobot, we are very focused on leveraging our attributes to continue to grow shareholder value.

I'll now turn the call back to Colin.

Colin

Our results for the second quarter exceeded our expectations in both divisions

- Our domestic home robot business grew **30%** and more importantly indicated a positive trend with respect to U.S. consumer spending;
- Our international home robot business continues to perform well in long-term markets as we prepare to expand into new markets;
- We successfully launched two new home robot products on our website and we expect wider distribution later in the year to contribute to the division's growth;

- We received several key orders for our government robots that validate the importance of our products to the warfighters and the willingness of the government to purchase them in the face of intense budget debate, and;
- We are confident that our G&I backlog coupled with a strong pipeline of opportunities, will enable us to meet our increased expectations.

Based on our improved outlook for the full year, we now expect

- Revenue of **$460-$470** million
- EPS of **$1.04-$1.10** and
- Adjusted EBITDA of **$62-$64** million.

With that we'll take your questions.

Following Q&A

Colin

That concludes our second quarter earnings call. We appreciate your support and look forward to talking with you again in October to discuss Q3 results.

Operator

That concludes the call. Participants may now disconnect.