iRobot First-Quarter 2016 Conference Call Script

Operator:

Good day everyone and welcome to the iRobot first-quarter 2016 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 2016 and the second quarter ending July 2, 2016, the growth, performance, revenue impact and prospects of our businesses including the international growth and revenue of our businesses, our expectations regarding seasonality and predictability of our businesses, our expectations regarding profitability; our expectations regarding revenue, the rate of revenue growth, Adjusted EBITDA, gross margins, operating expenses, marketing expenses, research and development expenses, general and administrative expenses, restructuring charges, stock compensation expenses, depreciation and amortization expenses, inventory, earnings per share, the impact of our continued marketing investments, the impact of our continued investments in technology, domestic and international demand for our home robots, demand and revenue opportunity for our wet floor care robotics, the mix of product revenue, and the impact on operating margins, the impact of our presence in China, the impact of the sale of our Defense & Security robots business that we closed on April 4, 2016, expenses related to the sale of Defense & Security robots business and our solicitation of proxies, our plans for expansion, our introduction and delivery of new products and the timing thereof, our introduction and delivery of new product capabilities and functionality, our competitive position, our market share and opportunity, 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, acquisition and divestiture 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 Q1 2016 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 May 4, 2016 and can be accessed by dialing **630-652-3042**, access code **40924297#.**

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the first quarter of 2016 as well as our outlook on the business for 2016; Alison Dean, Chief Financial Officer, will review our financial results for the first quarter of 2016; and, Colin and Alison will also provide our financial expectations for the second quarter ending July 2, 2016 and fiscal 2016. 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.

I am very excited to report that we had an outstanding first quarter.

- We delivered year-over-year Home Robot quarterly revenue growth in the United States of more than **50%** following record sell through during last year's holiday season;
- The overwhelmingly positive response to the introduction of our newest product, Braava jet™, resulted in the highest Day-1 unit sales in the company's history;
- Shortly after the end of the quarter, we closed the previously announced sale of our Defense & Security business, ending a proud chapter in iRobot's history and enabling our intense focus on our home business; and,
- We executed an **$85** million accelerated stock repurchase transaction, shortly after the end of the quarter, funded in part by the proceeds from the sale, consistent with our balanced approach to capital allocation. With this latest transaction, we will have returned almost **$100** million of excess capital to shareholders during 2016, while investing to grow the business in order to create shareholder value.

Based on our Q1 results and our outlook for the rest of 2016, our financial expectations are unchanged. We continue to expect 2016 revenue of **$630** to **$642** million, EPS of between **$1.20** and **$1.40** and adjusted EBITDA of **$80** to **$90** million or roughly **13 - 14%** of revenue**.**

These expectations reflect our confidence that Home Robot revenue growth of **12-13%** for the full year will be driven by strong demand in the U.S. and China. The success of the marketing programs we ran during the Q4 2015 holiday season, resulting in year-over-year sell-through of more than **70%** in the fourth quarter, caused U.S. retailers to re-stock their shelves in Q1, ahead of our expectations. We anticipate this momentum to continue throughout 2016 as heavy promotional activities begin again in the second quarter for Mother's Day and Father's Day. As we discussed last quarter, our 2016 expectations include strategic incremental investments, critical to achieving our 3-year financial targets. The investments will impact earnings in 2016 versus last year, as expected, to position the company for accelerated growth and improved profitability in 2017 and 2018.

The remaining expenses associated with the D&S divestiture and our proxy contest are additional one-time costs that will impact Q2 but our strong Q1 results enable us to reaffirm our earnings and Adjusted EBITDA expectations for the full year.

Now I'll take you through some of the details of the first quarter and our expectations for the rest of 2016.

Total year-over-year Home Robot revenue growth of **15%** in Q1 reflects sales of the Roomba 980, a new product, which we introduced in September 2015. Demand continues to be strong for our top-of-the-line Roomba as well as for our 800 and 600 series. In the United States, Q1 sell through at our top five U.S. retailers increased roughly **20%** over last year.

While Roomba is driving overall revenue growth this year, we are very excited by consumer reaction to our newest innovation, the Braava jet™ mopping robot. During the quarter, we delivered on our promise to introduce a new product, the second new product in less than a year. We began selling the Braava jet™ on our website in mid-March and it's been available in U.S. retail since the beginning of April. Reviews in the press and on Amazon have been very positive highlighting its price, design and the fact that it is the perfect complementary product to Roomba. In the third quarter, we expect Braava jet™ to be on shelves in China and Japan, where we expect to leverage the necessity for daily mopping and the Asian consumer's enthusiasm for automating this task.

Longer term, we expect the Braava jet™, with its disposable cleaning pads, to provide a future recurring revenue opportunity once we have built a reasonably sized installed base. With our newest product, in combination with our larger format Braava, we are very optimistic about developing our wet floor care business into a material, second revenue stream.

International Home Robot revenues declined **8%** year over year as expected. Revenue in EMEA was down **10%,** year-over-year as anticipated, due to distributor order timing. We expect EMEA's quarterly year-over-year revenue growth for the rest of the year to be robust and result in full-year growth of mid-single digits over 2015.

We saw a small year-on-year increase in Japan in Q1 in part due to the implementation of new marketing programs that proved to be highly successful in the U.S. during 2015. As you may recall, another part of our Sales & Marketing investment this year is earmarked for exporting our successful U.S. demand generation programs overseas to expand worldwide consumer adoption of Roomba. We have begun implementing these programs in Japan and, while it's still early, we are pleased with the results to date.

We are executing on the go-to-market transition in China we discussed on last quarter's call. As we said, in 2015, e-commerce was the growth driver, especially on the 11/11 and 12/12 holidays. We believe that China will grow to be our second largest market based on estimates that the robotic vacuum cleaner segment will grow to more than **$1** billion over the next **5** years. A critical piece of our 2016 incremental Sales & Marketing investment is focused on refining our go-to-market e-commerce strategy to further accelerate growth in this market. Our distributor's sell-out in China was more than double in Q1 over last year and Q2 is also expected to be more than double Q2 2015 sell-out. As we bring our new e-commerce partner on line, we are limiting new Q2 sell-in to our current partner, as planned, to keep regional inventory at an optimal level as we execute on this complex transition. Exiting Q2 we expect to be well-positioned for significant second half growth and capturing an even larger share of the rapidly growing Chinese market for robotic floor care. For the full year, we continue to expect APAC revenue growth of mid-high teens driven by China.

As we go forward, I am very excited about the next chapter for iRobot. We are poised for continued growth and success. Our Home Robots business has grown at a **16%** CAGR since 2012, setting the stage for accelerating consumer adoption and strengthening market share. Market leadership requires technology leadership and we are making disciplined R&D investments to maintain our leadership in robotic vacuum cleaning in addition to developing and growing significant adjacent categories in Home Robots.

Our strategy for leading the Home Robot market is driving us to substantially increase software capabilities as we leverage our navigation IP for the connected home. Both the Roomba 980 and Braava™ jet are significantly more complex products, delivering enhanced performance enabled by software. We have widened our competitive moat and will continue to pursue the significant opportunities within the consumer robotics market through ongoing technology innovation.

In summary, we are off to a good start in 2016 and our plan is on track:

- In the first quarter, we continued to see the positive impact of our targeted marketing programs as Home Robot revenue grew **15%** year over year following record Q4 revenue**;**
- We successfully launched our second new product in less than year, the Braava jet™, to rave reviews;
- We closed the sale of our Defense & Security business allowing us to focus our efforts more intensely on the vast home robotics market to improve shareholder value;
- We will continue to invest in key technologies to extend our market-leading position in consumer robotics.

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

Alison

We delivered first quarter revenue consistent with our expectations, with Home performing at the high end and D&S performing at the low end, and earnings per share and Adjusted EBITDA ahead of expectations due to higher than expected Home Robot gross margin. Revenue of **$131** million increased **11%** from Q1 last year driven by Home Robot growth in the U.S. EPS was **$0.13** for the quarter compared with **$0.16** for the same period last year. Q1 Adjusted EBITDA was **$14** million.

As Colin discussed, domestic Home Robot revenue grew more than **50%** in Q1 over last year. This growth was driven primarily by strong inventory replenishment by U.S. retailers. Expanded distribution by Bed, Bath & Beyond and Best Buy, as well as a lower price point for our Roomba 650 model, also contributed to increased revenue. Net revenue from life-to-date returns adjustments was **$1.0** million compared with **$1.1** million last year. International revenue declined roughly **8%** as expected due to lower year-over-year sales in both EMEA and APAC. We continue to expect mid-to-high teen full-year growth in APAC and mid-single digit growth in EMEA as we continue to roll-out distribution of the Roomba 980 and begin to sell Braava jet™ to overseas distributors.

We remain optimistic about the vast opportunities in the China market and are well on our way towards transitioning to a fully-operational Shanghai office by the end of the second quarter. We are confident that with an iRobot presence in country and a new trading partner for e-commerce, we will be able to more effectively focus on further accelerating revenue growth and quickly build China into our second largest market.

Defense & Security revenue of **$3** million in Q1 was lower than we anticipated. Scheduled Q1 deliveries were delayed until Q2 due to a customer's inability to perform acceptance testing before our quarter-end. The earn out of up to **$15** million, associated with the sale of the Defense & Security business, is tied to total 2016 revenue of the business, whether generated pre or post divestiture. The EPS and EBITDA impact of D&S for the Q1 stub period, as well as divestiture costs were a negative **($0.12)** and **($3.7**) million respectively during Q1, as expected. The close was effective April 4th, and therefore the final disclosure accounting will be completed in Q2. The full-year impact on EPS and EBITDA is expected to be negative **($0.10)** and **($2.6)** million respectively, more favorable than the Q1 impact due to the P&L benefit of transition services reimbursement and the gain we intend to book on the sale during Q2. In addition, it is important to note that our full year revenue guidance originally included a range for D&S of **$2-7** million**.** We will not record any D&S revenue other than the $**3** million in Q1, but we are also not changing our full year revenue guidance, as we expect Home to perform better than originally planned.

For the total company, gross margin was **47.4%** for the first quarter 2016, up **1.9** points from the same quarter last year. This was higher than we anticipated, primarily due to region and product mix in Home Robots. Domestic revenue was roughly **37%** of Q1 2015 revenue compared with nearly **50%** of Home Robot revenue in Q1 2016. In addition, our top-of-the-line Roomba 980 comprised **15%** of Q1 2016 revenue and wasn't available in Q1 last year.

Q1 operating expenses were **43%** of revenue, up from **39%** in Q1 last year primarily due to higher S&M spending to support the Braava jet™ launch and one-time G&A costs of **$2.5** million or **$0.06** of EPS, associated with the D&S sale and the proxy contest initiated by Red Mountain.

We ended the quarter with **$247** million in cash. The accounts receivable balance at year end 2015 was exceptionally high due to record revenue and shipments made late in Q4. Strong collections during Q1 were partially offset by **$12** million in share repurchases for a net **$34** million increase in cash. In April, we funded our Accelerated Stock Repurchase program of **$85** million, offset in part by the proceeds on the D&S sale, both of which will be reflected in our Q2 financials. With this latest stock repurchase, we have returned nearly **$100** million of excess capital to shareholders to date in 2016, while investing to grow the business in order to create shareholder value.

Total company DII of **86** days was higher than normal this quarter as it included an unusually high level of D&S inventory due to D&S revenue slipping from Q1 to Q2 due to customer acceptance timing as previously discussed. DII for Home Robots was **70** days as we built Braava jet™ to support the product launch. We expect Q2 ending inventory to return to our normal level of roughly **60** days.

As we have consistently said, while we provide quarterly expectations, we manage our business from a full-year perspective. Since 2006, more than **50%** of our Home Robot revenue has been delivered in the second half. We are on track for the year which we continue to expect to be back-end loaded, as we communicated in February. Throughout the rest of 2016, our quarterly year-over-year comparisons will be more challenging, due in part to the successful divestiture of the D&S business as well as the incremental investments we are making this year.

Now I'd like to provide you with additional detail for our Q2 financial expectations. Keep in mind that these expectations and growth rates are based only on our Home Robot business. We have provided a table in our press release to show a pro-forma view of D&S by quarter and for the full year 2015 for an easier comp analysis.

We expect second quarter Home Robot revenue of **$145** to **$150** million, an increase of **6%** to **10%** over Q2 last year driven by sales in the U.S. EPS is anticipated to be between **$0.06** to **$0.14,** and Adjusted EBITDA of between **$9** and **$12** million, both down from Q2 last year as expected. In addition to the typical Q2 increase in Sales & Marketing expense to promote Mothers' Day and Fathers' Day sales, Q2 opex also includes our continued investment in China, the execution of some of our new marketing programs overseas, and one-time costs of approximately **$3.0** million, or **$0.07** of EPS, associated with the proxy contest and the final expenses associated with the sale of D&S. We expect opex to increase as a percent of revenue in Q2, before declining to the low **30's** in the second half of the year. For the full year we continue to expect operating expenses to total **38** to

39% of revenues consistent with the expectations we provided on the February earnings call.

I'll now turn the call back to Colin.

Colin

We are off to an excellent start in 2016 as we focus our efforts on maintaining our position as the world's leading consumer robotics technology company.

With our efforts solely focused on robots for the home we are confident that we can accelerate the company's growth in the near term by seizing the tremendous opportunities we see in driving further worldwide adoption of robotic vacuum cleaners. Leveraging our robust portfolio of mapping and navigation software will enable us to further develop and grow significant adjacent categories in Home Robots longer term.

With that we'll take your questions.

Following Q&A

Colin

That concludes our first quarter 2016 earnings call. We appreciate your support and look forward to talking with you again in July to discuss our Q2 results.

Operator

That concludes the call. Participants may now disconnect.