iRobot Second-Quarter 2010 Conference Call Script

July 28, 2010

Operator:

Good day everyone and welcome to the iRobot second-quarter 2010 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 tax rate for fiscal 2010, the third quarter ending October 2, 2010, and the fourth quarter ending January 1, 2011, demand for the company's products and services, the timing of funding and contract awards under the FCS Program (now referred to as the Brigade Combat Team Modernization program), our plans for expansion and new product development and shipment, backlog and demand for our Government and Industrial robots and related parts and services, timing and order fulfillment, demand for our home robots, mix of product revenue 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 various 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 net income– the GAAP measure most directly comparable to Adjusted EBITDA - and Adjusted EBITDA is provided in the financial tables at the end of the Q2 2010 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 5, 2010 and can be accessed by dialing 617-801-6888, access code 69265770.

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 2010 as well as our financial expectations and outlook for the business for the rest of 2010; and John Leahy, Chief Financial Officer, will review our financial results for the second quarter of 2010 and provide additional detail on our financial expectations for fiscal 2010, the third quarter ending October 2, 2010, and the fourth quarter ending January 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.

I am very excited to report that we delivered record results for the second quarter and first half. Revenue of **$98** million for the quarter exceeded our expectations, and was **59%** greater than Q2 revenue in 2009. Adjusted EBITDA of **$12** million, and EPS **$0.20**, also far exceeded expectations.

Following outstanding performance by both divisions in the second quarter and good visibility on the rest of 2010, we are once again increasing our full year expectations. Our revenue and EPS expectations for the second half have increased since our April call; however, we have taken the opportunity to both increase our investment in the business AND increase our full year expectations due to our significant overachievement in the first half. We expect full year 2010 revenue of between **$385** and **$390** million, an increase of roughly **30%** over 2009. We are increasing our expectations for Adjusted EBITDA to **$36** to **$38** million**,** an improvement of approximately **75%** year over year, and our EPS range to **$0.51** to **$0.54,** more than quadruple our 2009 EPS.

These increased expectations demonstrate significant progress towards our three year financial goals of:

- Mid to high teen revenue CAGR;
- Mid-teen Adjusted EBITDA margins and;
- High single-digit operating cash flow margins

Profitable growth in the quarter was driven by both divisions. The home robot revenue increase was driven by broad-based growth internationally in European and Asian markets as well as in the U.S. Increasing demand for our products continues to outpace concerns about a softening EU economy, and our current manufacturing capacity. We were conservative in our planning as we brought on a new contract manufacturer, a scalable tier one manufacturing partner. They will be on line in Q4 to meet this growing demand in 2011 and beyond. Our Government & Industrial division's revenue growth resulted from shipments of more PackBot FasTac robots and spare parts than a year ago as well as the sale of a significant number of Small Unmanned Ground Vehicles in Q2.

Our continued focus on strengthening the balance sheet resulted in quarter-end cash and investments of **$99** million, up significantly from **$51** million a year ago. A critical component of improving our financial position over the past year has been driving Adjusted EBITDA and operating cash flow. Adjusted EBITDA was **$12 million,** or **13%** of revenue, compared with breakeven in Q2 2009, and we generated **$15** million of operating cash flow in the quarter.

Our U.S. strategy has been successful thus far. Not only did revenues grow **20%** in the second quarter year over year, but focus on creating the right mix of products and channels in domestic markets significantly increased gross margins. In Europe, most of our sales are dollar denominated, therefore the fluctuation of the Euro has minimal direct impact on international revenues. However, as the dollar strengthens against the Euro, our distributors' profit margins decrease and they have less money to spend on marketing efforts to promote our products. We have taken action to support our distributors, and some of the planned marketing expense in the second half will go towards our European partners' programs.

In the military business, despite the ever-shifting landscape in Washington, demand for our robots remains strong. Our robots are making a difference for soldiers in theater by providing increased situational awareness and improving mission success. In fact, a simulation using One Semi Automated Forces test methodology to measure the effectiveness of our SUGV (Small Unmanned Ground Vehicle) robot in combat, showed that with SUGV:

- Non line of sight effectiveness improved by **15 times**;
- Friendly casualties were reduced by **50%**; and
- Enemy losses per engagement increased **50%.**

These are compelling results that further support the use of robots.

As we have discussed over the past couple of quarters and at our analyst day, continuing investment in our people, our technology, our products and our brand is critical to building a sustainably profitable technology company. In the second half of the year we will put more resources against our common software/common platform long-term strategic vision, accelerated development of new products, marketing to support the holiday season and programs to support and continue building the iRobot brand. The current and foreseeable market dynamics in both divisions position us well to deliver a more profitable year than we had anticipated in April while we continue making robust and long term investments in building for our future and maintaining our market-leading position.

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

In Home Robots, strong demand for our Roomba 500 robots in international markets, as well as renewed demand domestically continues to fuel Home Robot growth. Home Robot revenue overseas increased **80%** 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. In Europe currency volatility has impacted our partners' economics somewhat, but we are committed to building the business and we expect continued strength in the second half. Our plan to enter the Latin and South American markets for the year-end holiday season is on track and we expect to begin generating nominal revenue there later this year.

In the United States, total domestic sales grew **20%** year over year, a positive directional indicator. 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 **9.6** percentage point improvement in home robot gross margins from **29.6%** in Q2 last year to **39.2%** this year. We are committed to our strategy of profitable growth; continuing to focus on higher-end products and exploring new channels. We see 2010 as a transitional year for the U.S. market and have not built our financial expectations around improved U.S. macros.

Our outlook for home robots is very positive and I am confident about meeting expectations despite continuing concerns over recession in Europe.

Our Government & Industrial division's results were also very strong for the quarter as we delivered **138** PackBot robots, the majority of which were FasTacs ordered under contracts we received in Q3 last year from the Robotics Joint Program Office. In addition we are beginning to ramp shipments of SUGVs, primarily SUGV 310s. During the quarter we shipped **100** SUGVs and, as anticipated, in July we received a new **$15** million order for **94** robots, our fifth under the existing IDIQ, of which **$32** million has been delivered through Q2 2010. Since we began shipping SUGVs in Q4 2009, we have received orders totaling **$47** million for **325** units and spare parts. This ramp rate is nearly four times that of the PackBot, at the same point following its introduction, which further illustrates the overwhelming adoption of robots by the military and urgent need from soldiers in theater.

To this end, in the fourth quarter, we will begin delivering our newest robot, the SUGV 320, to support the first increment of the Brigade Combat Team Modernization program. Under the LRIP (Low Rate Initial Production) contract, we will deliver **45** robots. In ongoing performance tests, our robots substantially exceeded requirements and were determined to be fully compliant. This is a significant milestone for us and sets the stage for 2011 when we expect the majority of G&I revenue to come from the sale of SUGVs.

Another of our recently introduced products, the Seaglider unmanned underwater robot, was shipped to the Gulf of Mexico on May 22nd. We saw an opportunity to respond to the need in the Gulf and sent an iRobot owned and operated Seaglider to search for underwater oil plumes and other anomalies. Based on data sent back from the robot, scientists were able to estimate the density of oil in the water as well as the extent to which it was spreading. Although we volunteered our products and services to help characterize this horrible disaster, we expect our increased exposure to yield future opportunities.

As we have discussed each quarter, a key component and growth driver of our Government & Industrial business is product lifecycle revenue or PLR. Our rapidly growing installed base of robots requires spare parts, support, maintenance and training. PLR, more than doubled year over year in the second quarter and we are on track to provide software enabled solutions through upgrades to more than **500** robots in the field during the second half of the year.

Beyond supplying robots to the U.S. Government, we continue to expand our international footprint. International revenue in the first half increased **46%** over the same quarter last year and comprised **10**% of G&I product revenue for the half.

In summary, both of our businesses are performing well in an uncertain environment and we expect both to grow approximately **30%** at the top line in 2010 while contributing a greater percentage to the bottom line. Because of our confidence in delivering more profitable results than we discussed in April, we are increasing our expectations for the full year.

For the full year we expect revenue to be between **$385** and **$390** million, EPS to be between **$0.51** and **$0.54**, and Adjusted EBITDA to be between **$36** and **$38** million.

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 was very strong as we achieved our first profitable Q2, and first half, since the company went public. Revenue, earnings per share and Adjusted EBITDA all exceeded expectations. Revenue was **$98** million and **$193** million for the second quarter and first half respectively, both all-time highs for the company. Growth in our international Home Robot business continued to be robust, up **80%** for the quarter year over year, and our Government & Industrial business was up **65%** for the quarter. Our overall revenue growth of nearly **60%** follows the strongest Q1 in the company's history.

Earnings per share for the quarter were **$0.20** compared with a loss of (**$0.10)** in Q2 2009. Adjusted EBITDA was **$12** million for Q2 and **$26** million year to date compared with breakeven last year. Operating cash flow of **$15** million in the second quarter has driven our cash and investments position to **$99** million, up **$48** million from Q2 last year. Year to date operating cash flow is **$25** million, compared with **$12** million in the first half of 2009.

Our focus on Adjusted EBITDA and cash flow continues to drive strong financial performance for the company.

In the Home Robot division, shipments grew **52%** to **294** thousand units and revenue of **$53** million increased **55%** from a year ago. International revenue increased more than **80%** in the quarter year over year and comprised **67%** of Home Robot revenue. Total domestic revenues increased **20%** year over year, an encouraging sign that U.S. consumers are beginning to spend again. Improvements in Home Robot gross margins were partly due to this increase in international as a percent of total revenue, and to our efforts to optimize our product and channel mix.

In the G&I Division, revenue was **$45** million, up **65%** from a year ago. This growth was driven by higher product shipments, primarily PackBot FasTacs, and higher contract revenue. Contract revenue comprised **26%** of G&I revenue for the quarter and was up **35%** year over year.

G&I product revenue was **$33** million in the second quarter, compared with **$19** million last year. Product lifecycle revenue was nearly **$10** million or **29%** of G&I product revenue, up from **$5** million in 2009. We expect PLR to average **25 – 30%** of G&I product revenue annually, although it can vary significantly quarter to quarter.

Product backlog at the end of the quarter was **$12** million, compared with **$18** million at the end of Q2 2009. This backlog position does not include the recent **$15** million order for SUGV 310s or a **$20** million order for **125** PackBots, both of which we expect to fulfill this year. Including these two orders, we have **80%** visibility of G&I's annual revenue contemplated by our full year guidance.

For the total company, gross margin for the quarter was **35%** compared with **27%** last year. The year over year increase was driven primarily by the improved home robot mix I mentioned earlier, and overhead leverage in G&I.

Operating expenses improved as a percentage of revenue to **26%** this year from **33%** in Q2 last year. The improvement resulted primarily from operating expense leverage, as well as marketing spend we deferred to the second half. However, we have added more than 100 employees, mostly in engineering and sales, since Q2 of last year.

Q2 operating cash flow was nearly **$15** million compared with a **$3** million negative cash flow last year. Year to date, operating cash flow is **$25** million.

Inventory was **$31** million at quarter end, relatively flat from a year ago despite higher revenues, and DII improved significantly. Accounts receivable continue to be well managed, as evidenced by our DSO of **27** days compared with **52** days a year ago.

At the end of Q2, we had cash, including investments, totaling **$99** million compared with **$51** million a year ago.

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 roughly **30%**, to a range of **$214** to **$216** million. Our G&I revenue expectations are unchanged, however we have narrowed the range to **$172** to **$174** million, also an increase of about **30%** year over year.

We expect Q3 to be another strong quarter, with revenue up roughly **20%** over last year. We anticipate revenue in the range of **$91** to **$94** million, EPS of **$0.05** to **$0.06** and Adjusted EBITDA of between **$5** million and **$6** million.

Q4 revenues should be slightly higher than Q3 but lower than our record-setting fourth quarter last year. The level distribution of revenues quarter to quarter throughout 2010 is largely due to our international home robot mix, and G&I revenues that have been much less lumpy than we have seen in the past.

We expect improved full year gross margins of **34-35%** 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.

Operating expenses in Q3 and Q4 will be higher than the first half due to marketing program commitments we've made to our international partners, expenditures made to support and strengthen our brand, and increased technical headcount. These expenses, coupled with the increased investment in R&D for new product development and software enhancements will result in lower EPS in the second half when compared to our very strong results in our first half. However, our expectations for revenue and EPS in the second half will be higher than we anticipated in our April call.

For the full year, we are increasing our expectations for revenue, EPS and Adjusted EBITDA.

Finally, we expect our increased full year earnings to translate into strong operating cash flow. For the full year, operating cash flow will be over **$35** million and our cash and investments will exceed **$100** million at year-end.

I'll now turn the call back to Colin.

Colin

I am very excited to be talking to you today, following great first half results, with the confidence to increase our full year 2010 expectations. Just to reiterate those expectations, we anticipate:

- Revenue of **$385-$390** million
- EPS of **$0.51-$0.54** and
- Adjusted EBITDA of **$36-$38** million.

We continue to successfully navigate through the dynamic and challenging global marketplace in which we operate. We're making significant progress towards our 3 year financial targets while making ongoing investments in building for our future and maintaining our market-leading position.

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.