

iRobot Second-quarter 2016 Conference Call Script

Operator:

Good day everyone and welcome to the iRobot second-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 third quarter ending October 1, 2016; the growth, performance, revenue impact and prospects of our business including outside of the United States; our expectations regarding seasonality and predictability of our business; our expectations regarding profitability; our expectations regarding revenue, the rate of revenue growth, net income, 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, and earnings per share; the impact of our exclusive focus on the consumer; the impact of strategic investments on our financial results; the impact of our continued sales and marketing investments; the impact of our continued investments in R&D and technology including our online operations; domestic and international demand for our robots; demand for, availability of and revenue opportunities associated with our Braava family of wet floor care robots; the impact of Brexit; the impact of our presence in China; the impact of our relationship with Amazon Web Services and our ability to support connected

robots and develop connected robot technologies; our plans for expansion; our introduction and delivery of new products and product capabilities and functionality, and the timing thereof; 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 Q2 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 August 4, 2016 and can be accessed by dialing **630-652-3042**, access code **40924298#**.

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 2016 as well as our

outlook on the business for 2016; Alison Dean, Chief Financial Officer, will review our financial results for the second quarter of 2016; and, Colin and Alison will also provide our financial expectations for the third quarter ending October 1, 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 happy to report that we had a very strong second quarter with revenue at the high end of the range, and earnings that exceeded our expectations. More importantly we have good visibility into the rest of 2016 and are raising both revenue and earnings expectations for the full year.

During Q2:

- We delivered year-over-year consumer quarterly revenue growth in the United States of more than **25%**, due to successful Mother's Day and Father's Day promotions, following record first quarter revenue;
- We opened our new office in Shanghai and have begun executing our more direct ecommerce strategy;
- Japan sell through continued to improve due to the successful implementation of iRobot marketing programs in that region; and,
- Due to nominal expectations for revenue in the UK, we expect no 2016 impact from Brexit.

Based on our Q2 results and our outlook for the rest of 2016 fueled by strong momentum in the U.S., we are increasing our financial expectations. We now expect 2016 revenue of **\$640 to \$645** million, Net Income of **\$36** million to **\$40** million, or roughly **6%** of revenue, EPS of between **\$1.26** and **\$1.40** and Adjusted EBITDA of **\$85 to \$90** million or roughly **13 - 14%** of revenue.

These expectations reflect our confidence that 2016 growth in the U.S. of more than **20%** will drive total consumer revenue growth of approximately **14%** for the full year. The success of the marketing programs we ran during Q2 for Mother's Day and Father's Day, resulted in U.S. sell through that was up roughly **20%** in the quarter vs. last year. We anticipate this momentum to continue throughout 2016 as retailers begin to stock their shelves for the holiday season in late Q3, followed by significant promotional activities again in the fourth quarter. 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. We are beginning to see the positive impact from our incremental S&M investments in overseas markets, such as Japan, as we implement the programs that have been highly successful in driving demand generation in the U.S.

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

Total year-over-year consumer revenue growth of **8%** in Q2 reflects demand for our high end Roomba 980, as well as for our 600 series Roomba and the Braava family of wet floor care robots.

Through the second quarter, Braava jet™, which we introduced in late Q1, was available only in the U.S. In the third quarter, it will 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. We will also be launching Braava jet™ in Europe at the end of Q3 in time for the holiday season.

Sales of Braava jet™, in combination with increased sales of the larger format Braava, fuel our optimism about developing our wet floor care business into a material, second revenue stream.

Revenue in EMEA was up **7%**, year over year in Q2 2016 as anticipated. We continue to expect EMEA's quarterly revenue to grow through the rest of the year and result in full-year growth of mid-single digits over 2015.

For the third quarter in a row, revenue in Japan increased year-on-year in Q2, due in part 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, which we discussed on last quarter's call, to provide us with more direct control over our ecommerce channel. Sell-out in China was more than **50%** in Q2 over last year, and more than **75%** through the first half, which left us well-positioned for significant second-half growth in China and capturing an even larger share of the rapidly growing Chinese market for robotic floor care. We launched our new ecommerce operations at the beginning of Q3 and expect the significant 11/11 and 12/12 online holidays, to benefit from those enhanced operations. For the full year, we now expect APAC revenue growth of low-double digits driven by both Japan and China.

International consumer revenue was down slightly in the second quarter from last year, as expected, due to the go-to-market transition in China.

On another note, we recently announced a new relationship with Amazon Web Services (AWS) that we believe will enable iRobot to address significant opportunities within our consumer business and the connected home. AWS is a managed cloud solution that enables connected devices to interact easily and securely with cloud applications and other devices. The AWS Cloud will enable iRobot to scale the number of connected robots it supports globally and allow for increased capabilities in the smart home. This is a huge step forward for us as we address strategically important cloud robotics technologies. With its broad, rich services and world-class infrastructure, the AWS Cloud infrastructure will enable iRobot to more efficiently develop connected robot technologies and expand the value of robots within the smart home.

During the second quarter we made the decision to end our remaining Remote Presence marketing and business development initiatives. As we reported on our Q4 2015 call, we had already reallocated R&D resources, from a next generation Remote Presence platform, to consumer opportunities. Going forward, **100%** of the company's resources will be exclusively focused on the consumer as our customer and I am very excited about the next chapter for iRobot.

We are poised for continued growth and success. Maintaining our market-leading position requires technology leadership. We will continue to make disciplined R&D investments to ensure that we remain the leader in robotic vacuum cleaning while developing and growing significant adjacent consumer product categories.

In summary, we continue to execute successfully against our plan, delivering excellent first-half performance. Those first half results, coupled with continuing momentum in the U.S. enable us to increase our financial expectations for the full year.

- In the second quarter, we continued to see the positive impact of our targeted marketing programs as U.S revenue grew **40%** year-over-year in the first half over 2015;
- We better positioned ourselves in China to accelerate second-half revenue growth and capitalize on the large and growing opportunity in that market;
- We fully exited the Remote Presence business allowing us to focus our efforts solely on the vast home robotics market; and,
- 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 second quarter results in more detail.

Alison

We delivered second quarter revenue consistent with our expectations, and earnings per share and Adjusted EBITDA ahead of expectations due to the timing of certain operating expenses. Consumer revenue of **\$148** million increased **8%** over Q2 last year. Second-quarter 2016 revenue includes approximately **\$1.2** million of favorable return reserve adjustments compared with **\$2.6** million in 2015.

As a reminder, total company revenue of **\$149** million for the second quarter 2015 included **\$12** million of D&S revenue compared with zero in Q2 2016, following the divestiture of that business at the end of Q1. Net Income was **\$4.8** million in Q2 vs **\$7.3** million in 2015. EPS was **\$0.17** for the quarter compared with **\$0.24** for the same period last year, and Q2 2016 Adjusted EBITDA was **\$16** million.

For the first half, revenue was **\$280** million compared with **\$267** million in 2015; net income was **\$8.7** million compared with **\$12.0** million last year; EPS was **\$0.30** compared with **\$0.40** and Adjusted EBITDA was **\$30** million compared with **\$31** million last year. Keep in mind that 2016 first half results include, Defense & Security revenue of **\$3** million versus **\$18** million in the first half of 2015, as well as divestiture costs that negatively impacted net income by **\$3** million, EPS by **(\$0.11)** and Adjusted EBITDA by **(\$3.3** million).

As Colin discussed, domestic revenue grew more than **25%** in Q2 over last year. This growth was driven primarily by strong demand for our high-end Roombas, as well as the Roomba 600 series and the Braava family of wet floor care robots. International revenue was down slightly as expected and results varied from region to region. EMEA and Japan both delivered year-over-year growth. While China sell-through was up significantly again in the second quarter, revenue declined year over year as we completed the transition to our new online distribution partner in that market. We've lowered second half growth expectations slightly, due to the transition, but still expect APAC to deliver low-double digit growth for the year over 2015 driven by growth in both China and Japan. We continue to expect mid-single digit growth in EMEA as we roll-out distribution of the Roomba 980 and begin to sell Braava jet™ in overseas markets. Our revised expectations in APAC for

2016 are more than offset by increased expectations in the U.S. which continues to benefit from our investments in sales & marketing programs.

Gross margin was **46.8%** for the second quarter 2016, down slightly from the same quarter last year. This decline was driven by one-time Remote Presence shutdown costs of **\$1.7 million**, **\$1.3 million** of which negatively impacted gross margin, as well as lower Q2 2016 return reserve adjustments compared with last year.

Q2 operating expenses were **43%** of revenue, up from **40%** in Q2 last year primarily due to higher S&M spending to support the Braava jet™ launch and to drive Roomba adoption, and one-time G&A costs of **\$1.5 million** or **\$0.03** of EPS, associated with the proxy contest and **\$0.3 million** of the Remote Presence shutdown costs.

We ended the quarter with **\$173 million** in cash and investments. As we mentioned on last quarter's call, in April, we funded our Accelerated Stock Repurchase program of **\$85 million**. Coupled with the **\$12 million** in share repurchases we executed in the first quarter, 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 **54** days was consistent with our typical Q2 level. We anticipate higher inventory levels at the end of Q3 as we prepare to ship to U.S. retailers for the holiday season.

Now I'd like to provide you with additional detail for our Q3 financial expectations. Keep in mind that these expectations and growth rates are based only on our consumer business. As a reminder, we provided a table in our Q1 2016 press release showing a pro-forma view of D&S by quarter and for the full year 2015 for an easier comp analysis.

We expect third quarter revenue of **\$155 to \$160 million**, an increase of **14% to 17%** over Q3 last year driven by sales in the U.S. Net income is expected to be **\$11 million to \$13**

million, or roughly **7%** to **8%** of revenue, EPS is anticipated to be between **\$0.40** to **\$0.45**, and Adjusted EBITDA of between **\$25** and **\$28** million, or **16-18%** of revenue. 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.

The full-year impact of the D&S divestiture on net income, EPS and EBITDA is expected to be negative (**\$3** million), (**\$0.10**) and (**\$2.7** million) respectively. In addition, it is important to note that our full year revenue guidance includes only the **\$3** million D&S revenue we recognized in Q1.

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 consumer robot categories longer term.

With that we'll take your questions.

Following Q&A

Colin

That concludes our second quarter 2016 earnings call. We appreciate your support and look forward to talking with you again in October to discuss our Q3 results.

Operator Participants may now disconnect.