iRobot First-Quarter 2019 Conference Call

Operator:

Good day everyone and welcome to the iRobot first-quarter 2019 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 2019 and each quarter thereof; the growth, performance, revenue impact and prospects of our business, including in the United States, EMEA, Japan and China; our expectations regarding profitability; our expectations regarding revenue, the rate of revenue growth, gross margins, operating income, operating expenses, operating margin, sales & marketing expenses, research and development expenses, general and administrative expenses, restructuring charges, stock compensation expenses, depreciation and amortization expenses, inventory, tax rate, earnings per share and cash; the seasonality and predictability of our business; our expectations regarding currency exchange rates; our expectations regarding our ability to penetrate further the robotic vacuum cleaner and wet floor care markets; the impact of our continued investments in sales & marketing and in R&D, technology and innovation; the impact of our efforts to increase consistency and awareness of our brand and to protect our IP; domestic and international demand for robotic vacuum cleaners (RVC) and our RVC products; demand for and revenue and revenue growth opportunities associated with our wet floor care products, including our

Braava family of floor mopping robots; our intent to make, and the impact on our financial results of, strategic investments; our intent regarding the introduction and delivery of new products, applications and product capabilities and functionality, and the timing and impact thereof; our intent to diversify our supply chain and manufacturing capabilities; our plans relating to any potential increase in tariffs of goods imported into the United States; our market share and opportunity; our collaboration with Amazon; 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 may also disclose non-GAAP financial measures as defined by SEC Regulation G, including Adjusted EBITDA, non-GAAP gross profit, non-GAAP operating income, non-GAAP income tax expense, non-GAAP net income and non-GAAP net income per share. Our definitions of these non-GAAP financial measures, and reconciliations of each of these non-GAAP financial measures to the most directly comparable GAAP measure, are provided in the financial tables at the end of the first-quarter 2019 earnings press release issued last evening, which is available on our website: http://investor.irobot.com/news-releases?field_nir_news_date_value%5Bmin%5D=2019#views-exposed-form-widget-news-widget-news-ul

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 April 30, 2019 and can be accessed by dialing **404-537-3406**, access code **9766025.**

On today's call, iRobot Chairman & CEO Colin Angle will review the company's operations and achievements for the first quarter of 2019 and Alison Dean, Chief Financial Officer, will review our financial results for the first quarter of 2019. Colin and Alison will also provide our business and financial expectations for fiscal 2019. 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.

We delivered strong Q1 results. First quarter revenue grew **9%** over Q1 2018 as expected. Q1 sell-through was good, setting us up for the higher year-over-year Q2 2019 revenue growth rate we discussed last quarter.

Given our Q1 results and our outlook for the rest of the year, we are reaffirming our 2019 full-year revenue and operating income expectations and increasing our full-year expectations for earnings per share. We still expect full-year 2019 revenue of **1.28** to **1.31** billion dollars, which is year-over-year growth of **17 – 20%,** operating income of **108** to **118** million dollars, and now expect EPS of **$3.15** to **$3.40** driven by the **$0.14** favorable discrete tax impact we recorded in Q1.

Keep in mind that quarterly revenue growth by region, as well as the quarterly timing of operating expenses incurred, have varied widely throughout prior years and we expect fluctuations again this year. We manage the business on an annual basis and encourage investors to view us accordingly.

Now I'll take you through some of the highlights of Q1 2019, and our business expectations for the rest of the year.

First, we successfully launched the Roomba i7/i7+ in EMEA, Japan and China. Customers love this product! The feedback we received from our millions of previous customers has directed our "Experience Driven Design" approach which significantly differentiates us from would-be competitors. Our track record of superior performance, product quality and reliability drives a high level of consumer engagement, supporting iRobot brand loyalty, and our ongoing segment leadership. By analyzing the information available to us, with permission of our customers, we are able to see their level of engagement with our connected products: how often and for how long they are using Roomba; how frequently missions are completed; whether they are using the directed room cleaning available in our latest premium model and so on. We believe that our successful execution against our strategy will fuel our growth over the next couple of years as the competition is either consolidated or exits the segment.

Now turning to our first-quarter performance by region, we delivered **7%** year-over-year revenue growth in the U.S. while international revenue increased **12%**. In the United States, retailers exited 2018 with more inventory than in prior years likely driven in part by a desire obtain inventory ahead of the tariff increase originally scheduled for January 1st. As planned, we increased pricing on the i7/i7+ at the beginning of the year to partially offset the impact of tariffs. Despite the higher prices, Q1 demand was ahead of plan for this product. In EMEA, revenue grew **7**% as retailers prepared for the Roomba i7/i7+ launch in that region. Japan revenue grew **26%** in Q1 over 2018, as the strong momentum experienced in Q4 2018 continued into the first quarter. We still expect full-year double digit revenue growth domestically and overseas.

On another note, I am pleased to report that iRobot has been selected by Amazon as the principal smart home participant in re:MARS, its major new conference on AI and robotics. We will be collaborating with Amazon to demonstrate a full-scale smart home featuring Alexa enabled iRobot devices. Additionally, I will be delivering a keynote speech, at the conference, on AI and the smart home.

In summary, 2019 is off to a good start as we deliver against the commitments we introduced last quarter to:

- Roll out Roomba i7/i7+ and e5 overseas;
- Drive further adoption of Braava;
- Diversify our portfolio with the introduction of our revolutionary autonomous lawn mower;
- Create strategic long-term supply chain flexibility by beginning production outside of China in 2019;

- Continuing to invest in innovation to extend our technology and product leadership; and,
- Introduce new products in Q2.

With the launch of two new products in the second quarter, along with the Terra launch later this year, we will have introduced **five** major new products in the past 12 months.

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

Alison

Our first quarter revenue was in line with our expectations, and operating income and EPS were ahead mostly due to the timing of operating expenses we initially expected in Q1 and the impact of a stock compensation windfall that was not previously forecasted. Quarterly revenue of **$238** million increased **9%** from Q1 last year, as expected. Operating income for Q1 was **$22** million compared with **$25** million for Q1 2018. EPS was **$0.78** for the quarter, compared with **$0.71** in Q1 2018**.** Q1 2019 EPS included a net discrete tax benefit of **$0.14** compared with a net discrete tax benefit of **$0.05** in Q1 2018. Our Q1 2019 effective tax rate, before discrete items, was **21%**, versus our Q1 2018 rate, before discrete items, of **27%,** in line with our expectations. The year on year improvement to our tax rate before discrete items was largely driven by the benefits of the U.S. tax reform act of 2017, which negatively impacted the Q1 2018 rate, and the benefits of our UK principal company established in 2018. The effective tax rate for Q1 2019 inclusive of discrete items was **4%** compared with **21%** for Q1 2018. The biggest driver of the discrete benefits each year were the stock compensation windfalls of **$0.20** in Q1 2019 versus **$0.05** in Q1 2018.

Revenue growth of **9%** for Q1, included domestic growth of **7%**, EMEA growth of **7%** and Japan growth of **26%.** We still anticipate roughly **60%** of our annual revenue to be generated in the second half of the year and we are on track to deliver the full-year expectations we discussed in February.

Gross margin was **50%** for the first quarter, compared with **53%** in Q1 2018. The **300** basis point decrease was due primarily to pricing and promotional activity – particularly as we transition in the new products. We expect Q1 will be the highest gross margin quarter for 2019, and we still expect gross margin for the year to be approximately **48%**.

Q1 operating expenses were **41%** of revenue, down from **42**% in Q1 last year primarily due to the timing of sales & marketing expenses we expected to incur in Q1 that we now expect in Q2.

We ended Q1 with **$200** million in cash, up from **$162** million at year-end. We have been rebuilding our cash position following the 2017 acquisitions and the **$50** million stock repurchase we completed during 2018.

Q1 ending inventory was **$181** million or **140** days compared with **$112** million, or **101** days last year, as we prepared for the product transitions. In addition, recall our US inventory value now includes the impact of tariffs. Given our global roll-out cadence for new products and our supply chain diversification strategy, we are likely to continue to see inventory at an elevated level for the next quarter or two, before declining again at year end. As a result, average DII for 2019 will likely be higher than the previous 100 day average. I expect inventory days will normalize in 2020.

Now I'd like to provide you with additional detail and some of the underlying assumptions for our full-year 2019 financial expectations and some quarterly color. As Colin has discussed, we manage our business from a full-year perspective. Likewise, our 2019 financial expectations should be viewed on a full-year basis as quarterly year-over-year revenue growth rates, and overall results, will vary greatly by region due to a number of factors including new product introductions and product transitions.

For 2019 we continue to expect full year revenue of **1.28** billion to **1.31** billion dollars, which is year-over-year growth of **17%** to **20%**. As in the past several years, we expect revenue will be more heavily weighted in the second half of the year when we expect to deliver roughly **60%** of the year's revenue. Our revenue expectations contemplate Yen and Euro exchange rates roughly in line with current rates, **+/- 5%**.

For the full year, we continue to expect operating expenses to total roughly **40%** of revenue, a **100** basis point improvement over 2018 as we begin to leverage the investments we've made over the past couple of years.

We continue to expect full-year operating income of **$108** to **$118** million and now expect EPS of **$3.15** to **$3.40,** driven by the **$0.14** net favorable impact from discrete tax items, primarily the stock compensation windfall that we recorded in the first quarter.

From a quarterly perspective, we continue to expect year-over-year revenue growth rates to be the highest in Q2 and Q4 due in part to the anticipated timing of new product introductions and distribution rollout. In Q2 we expect year-over-year revenue growth in the high teens.

Gross margin is expected to be the lowest in Q2 and Q3 due to the introduction and rollout of new products in Q2 at margins that are lower than the cost-optimized products they are replacing, as well as our supply chain diversification investment and the traditionally heavy promotional activities associated with Mother's Day and Father's Day.

In addition, our sales and marketing expense is expected to increase more than usual in Q2 to support the three new major product introductions this year. All in, operating income for Q2 could be break-even to slightly negative, however we expect to deliver operating income in the second-half of the year sufficient to meet our full-year operating income expectations.

As it relates to tariffs, on January 1, 2019, we increased prices on our premium i7 and i7+ robots sold in the U.S. to help offset the impact of the **10%** tariff cost we are incurring on all Roomba imports into the US. At the **10%** level, we anticipate **$20-25** million of tariff costs to be incurred in 2019. As currently structured, the U.S. government has indefinitely postponed its increase in tariffs to **25%** which was originally planned for March 1, 2019. If tariffs are increased at some point in 2019, we would likely increase our prices again to offset the incremental tariff costs incurred. Should the tariffs be lifted altogether, we would expect to lower prices to their pre-tariff levels. Any change in tariffs would take time to implement as we and our retailers work through channel inventory and we provide any contractual price change notifications to our partners.

In summary, we are pleased with our Q1 results which are in line with our full-year expectations

I'll now turn the call back to Colin.

Colin

2019 is off to a good start and I am very excited about the year ahead. We expect our global business to deliver strong financial performance in 2019 that will fund our ability to:

- Reinforce our core product leadership in the RVC category;
- Expand and diversify our product portfolio;
- Widen our competitive moat through technological differentiation protected by our IP portfolio; and,
- Broaden our manufacturing and supply chain outside China.

We believe that consistent execution of this strategy is the most effective way to drive sustainable growth and shareholder value.

With that we'll take your questions.

Following Q&A
Colin
That concludes our first quarter 2019 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.