# iRobot Fourth-Quarter and Full Year 2012 Conference Call Script

**Operator:**

Good day everyone and welcome to the iRobot fourth-quarter and full year 2012 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 2013 and the first quarter ending March 30, 2013, the growth and revenue impact of our businesses, our expectations regarding profitability, our expectations regarding revenue, Adjusted EBITDA, operating cash flow, operating expenses, gross margins, restructuring charges, stock compensation expenses, depreciation and amortization expenses, tax rates and earnings per share, demand for our home robots, international home robot revenue, the impact of our Mint® robot, the timing and fulfillment of government contracts and orders, demand for and adoption of our Defense and Security robots and related parts and services, orders for and sales and deliveries of our PackBot, SUGV and FirstLook® robots, our Defense and Security contract, product lifecycle and recurring revenue, international Defense and Security, mix of product revenue and impact on operating margins, our integration of Evolution Robotics, the impact of our acquisition of Evolution Robotics on our financial results, our plans for expansion, our introduction and delivery of new products and new product capabilities and functionality, the impact of our RP-VITA robot on our financial results, the availability, capabilities and functionality of new technology, 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, restructuring expenses, net intellectual property litigation 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 Q4 and full year 2012 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 February 16, 2013 and can be accessed by dialing **630 652-3042**, access code **31615791#.**

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the fourth quarter and full year 2012 as well as our outlook on the business for 2013; and John Leahy, Chief Financial Officer, will review our financial results for the fourth quarter and full year 2012 and, Colin and

John will also provide our financial expectations for the first quarter ending March 30, 2013 and fiscal 2013. 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.

2012 was a transformational year for our business and as we enter 2013, we are a different company than we were a year ago. Our business performance over the next few years will be primarily driven by our rapidly growing home technology business. Home Robots is expected to grow roughly **20%** this year and comprise **90%** of total company revenue. In addition, we are developing a remote presence business and have stabilized our defense business. We are excited to be driving forward on a solid foundation again.

Last evening, we reported Q4 and full year results. We delivered EPS and Adjusted EBITDA exceeding our fourth quarter and full year expectations, on revenue in line with our expectations. Full-year 2012 revenue was **$436** million down just **6%** year over year despite a decline of more than **$100** million in D&S revenue. Earnings per share were **$0.61** and Adjusted EBITDA was **$52** million or **12%** of revenue. Our Home Robot results were exceptional and it is important not to allow them to be over-shadowed by the decline in D&S revenue.

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Fiscal 2012 was truly a tale of two cities at iRobot.

- Our Home Robot business had a phenomenal year. Revenue increased **28%** over 2011 and comprised **82%** of the company's total revenue for the year.
- Our Defense & Security business was impacted by troop withdrawals in Afghanistan, a continuing resolution and uncertainty around sequestration. As a result we reported a significant reduction in D&S revenue year-over-year.

Full year Home Robot revenues were driven by strong growth in both domestic and international markets. Expanded distribution of the Roomba 700® series and the introduction of the Roomba 600 series were the primary drivers. Throughout the year, we saw a direct correlation between our investment in marketing programs to generate greater brand awareness and revenue growth. In the second quarter we launched a multi-media advertising campaign in the U.S aimed at the modern professional to drive premium brand identity. The program helped domestic revenue grow more than **40%** year over year. Likewise, our continuing investment to improve Home Robot product quality resulted in an adjustment to our product returns accrual that positively impacted revenue and profit. Higher quality robots and improved operational performance coupled with a premium ad campaign have proven to be a successful formula. We will continue to invest in these and other initiatives that expand our competitive moat and secure our market-leading position.

Our international Home Robot revenues grew more than **20%** year-over-year**.** More than **80%** of the year over year growth came from countries where we have been selling Roomba products since 2008 which clearly demonstrates that increased market penetration, and not geographic expansion, is driving sales. The strong demand for our products overseas, despite the negative macros, is due in part to continued investment by our distributors in marketing initiatives and also to an increasing awareness that robotic vacuum cleaners can replace traditional vacuum cleaners**.** Both Asia Pacific and Europe were up roughly **20%** year-over-year driven by growth in Japan and Western Europe in their respective markets**.**

We expect continued growth in both the U.S. and overseas markets from expanded distribution of new products, deeper penetration of existing markets and further expansion into Latin America and China. Revenue growth of approximately **20%** in 2013 assumes integration of Mint®, our floor sweeping robot, into domestic channels and initial sales to European distributors by midyear, six months ahead of schedule. We expect revenue in China and Latin America to comprise roughly **30%** of the year over year overseas growth. This will be the first meaningful contribution to growth from geographic expansion since we entered the overseas markets in 2008. Overall international revenue is expected to grow at roughly the same rate as in 2012. We are exiting 2012 with strong overseas growth but given the continuing economic uncertainties in Europe, we are assuming lower 2013 growth in EMEA. While we are not seeing evidence of a significant downturn in current market data, we are being cautious about the negative macros and have set our expectations accordingly.

As we closed 2012, inventory levels at both domestic retailers and international distributors were lean, positioning us well for a solid start to 2013. Our Home Robot product pipeline is the most robust it has been in our company's history and the multi-year outlook is very positive. I am confident that we'll continue to see strong growth driven by further penetration in domestic and international markets, and expansion of new product distribution.

The robot segment remains the fastest growing segment of the floor care category while the penetration rate is less than **10%** worldwide. We saw a tremendous opportunity to expand our product offerings in this category through our acquisition of Evolution Robotics (ER).

We continue to be on schedule with our integration of ER. Selective iRobot domestic retailers are in the process of adding Mint products to their floor care line and we expect that process to be complete before this year's holiday season. The Mint product is tailor-made for European and Asian markets and we are ahead of our planned rollout to international distributors. We originally expected to begin shipping overseas in 2014. Our operations team is working with ER contract manufacturers and component suppliers to implement savings resulting from our combined purchasing power. Expectations for the financial impact of the acquisition remain unchanged at this point for 2013.

We are optimistic about our ability to capture an increasing slice of the global robotic floor care market and believe double digit growth is likely for years to come. Our go to market strategies have served us well and will not change in 2013. As always, we will balance continuing investments to support growth initiatives with generating increased profitability.

In 2011, we made our first foray into the healthcare market with considerable ir&d investment and work done under a joint development and licensing agreement with InTouch Health. In 2012, in conjunction with InTouch, we introduced RP-VITA, our human interface autonomous navigation robot. We recently received FDA approval for RP-VITA, the first self-navigating communications robot for use in hospitals.

FDA approval of a robot that can safely and independently move through a fast-paced, chaotic and demanding hospital environment is a significant milestone for the robotics and healthcare industries. There are very few environments as difficult to maneuver as that of a busy ICU or emergency department. Having crossed this technology threshold, the potential for self-navigating robots in other markets, and for new applications, is virtually limitless.

We began shipping the RP-VITA to InTouch in Q1 2013. They will integrate their proprietary technology for telemedicine and electronic health records to facilitate its use in remote diagnosis and treatment. We are very excited about our progress in this segment and expect the product to contribute materially to revenue in the next couple of years.

Beyond the healthcare market we are exploring other opportunities for our tele-presence platform.

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As we discussed throughout 2012, troop withdrawals, a continuing resolution, program cancellations, and ongoing budget reductions negatively impacted our Defense & Security business. We continue to believe the longer term prospects for our unmanned ground vehicles are positive. Near term however, we have limited visibility.

We recently received a **$7** million order from a foreign government for PackBot® systems. The order is an encouraging indication that the investments we have made over the years to develop an international market opportunity are beginning to bear fruit. In fact, we expect international sales to contribute roughly one-third of 2013 product revenue in our Defense and Security business unit. The balance of 2013 revenue will come from product lifecycle revenue to support our installed base of more than 5,000 unmanned ground vehicles plus orders for FirstLook®.

The continued development of SUGV and subsequent production timing is uncertain so we are not assuming any BCTM SUGV production shipments in the 2013 expectations. As we discussed last quarter, we right-sized staffing to a level that would enable us to generate a positive gross margin and a breakeven contribution margin.

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In summary, while 2012 was a transformational year, during which our home business grew dramatically and our defense business struggled, 2013 will be a return to growth year.

- Home Robot revenue will continue to grow in both domestic and overseas markets and comprise roughly **90%** of total company revenue;
- We will continue to invest in marketing programs and product quality initiatives that drive profitable Home Robot growth;
- We will explore health care and other opportunities in the tele-presence market, and;
- We will continue to track developments in Washington that impact our Defense and Security business, to ensure that our cost structure remains consistent with revenue expectations.

I will now turn the call over to John to review our fourth quarter and full year results in more detail.

**John**

Thanks Colin.

Our fourth quarter revenue of **$101 million** was in-line with our expectations, while earnings per share, Adjusted EBITDA and operating cash flow all exceeded our expectations. Home Robot revenue of **$83** million was up **11%** for the quarter driven by strong domestic growth, further evidence that our advertising investments and channel strategies are yielding positive results.

Loss per share for the quarter was **($0.21)** and earnings per share for the year were **$0.61.** As we discussed on our October call, Q4 EPS includes a negative impact of **$0.22** from restructuring our D&S business and the inclusion of Evolution Robotics, which we acquired on October 1. Full year Adjusted EBITDA of **$52** million was negatively impacted by **$5** million due to ER.

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Domestic Home Robot revenue growth of **32%** in Q4 helped drive year over year growth of more than **40%** for the domestic business, while international revenue grew **22%** for the full year. Home Robot gross margins improved **400** basis points in the quarter and for the full year, primarily due to benefits resulting from improved product quality and product mix. The Q4 performance of the acquired ER business was in line with our expectations.

Defense & Security revenue of **$18** million decreased from a year ago due to both lower contract and product revenue. Defense & Security product revenue was **$15** million in the fourth quarter most of which was product lifecycle revenue. Current backlog of **$18** million includes the **$7** million international order we received in Q1.

For the total company, gross margin was **41%** for both the quarter and the year.

Q4 operating expenses were **50%** of revenue compared with **31%** in Q4 last year. The quarterly increase was largely due to the inclusion of Evolution Robotics expenses and costs associated with the D&S restructuring.

Q4 operating cash flow was **$27** million. For the full year, operating cash flow was **$38** million, or **9%** of revenue.

Now I'd like to provide you with additional detail and some of the underlying assumptions for our 2013 financial expectations. The outlook for our Home Robot business remains very strong with growth drivers identified for the next couple of years. For the government business, our visibility is again limited in 2013. U.S. budget pressures coupled with a continuing resolution and sequestration increase the uncertainty. As we said on our third quarter call, we expect 2013 D&S revenue to decline from 2012 levels.

We have raised the low end of the preliminary full year revenue expectations we provided last quarter. We expect full year revenue of **$480** to **$490** million comprised of Home Robot revenue of **$430** to **$435** million and D&S revenue of **$45** to **$55** million. We anticipate a nominal revenue contribution from our Remote Presence business unit. We expect Q1 revenue of **$98** to **$102** million which is up slightly year-over-year.

In Home Robots, growth will be driven by further penetration of long time overseas markets, coupled with expansion into new geographies and wider distribution of the Roomba® 600 and 700 and Mint®. Overall we expect home robots to grow roughly **20%** in 2013.

We expect approximately half of D&S product unit revenue to come from PackBot® sales and PLR to support the installed base of PackBot robots, and the balance from FirstLook® and SUGV. Contract revenue is expected to be roughly **$5** million and product lifecycle revenue is expected to total approximately **25 - 30%** of product revenue.

Our expectations for the ER business are consistent with what we communicated in October, with 2013 revenue of **$22 - $24** million, loss per share of **($0.22) – ($0.26)**, and accretive in Q4 and beyond. Roughly **$0.12** of the loss is non-cash.

We expect Q1 EPS of **$0.00** to **$0.07** and full-year of **$0.57** to **$0.72**. Adjusted EBITDA in Q1 is expected to be **$4** to **$6** million and full-year **$46** to **$52** million. Our EPS and Adjusted EBITDA comparables are impacted by the positive product returns accrual adjustments in Q2 and Q3 2012, as well as the full year impact of ER in 2013.

Investments in IR&D for our home and remote presence businesses, increased marketing spend in Home, and ER expenses will cause operating expense to increase to approximately **38%** of revenue for the full year. As we complete the integration of Evolution in the fourth quarter and it becomes accretive, we will return to more normal opex levels exiting the year. Operating cash flow will be **$20-25** million, largely driven by net income.

We are also assuming:

- Stock comp expense of roughly **$13** million;
- Depreciation and amortization expense of approximately **$15** million; and,
- Diluted share count of **29** million shares.

We are estimating a tax rate of **8-10%** for 2013. We have assumed in our rate the investment tax credit for R&D which was approved by Congress for 2012 and 2013.

I'll now turn the call back to Colin.

**Colin**

We expect our Home Robot business to deliver robust results in 2013; while further declines in our defense business will dampen growth this year. However, with our Home Robot business comprising roughly **90%** of our revenue, we have improved visibility, greater financial predictability, improved profitability profile and an opportunity to more strategically invest in our business.

We continue to believe that longer term there is a larger role for our government robots in the military's modernization plan. In the near term however, we have made decisions that benefit the whole company and confirm our commitment to profitable growth.

2012 was a tough year during which we made difficult decisions but as a result we are better positioned to return to the profitable growth trajectory we were on through 2011.

With that we'll take your questions.

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**Following Q&A**

**Colin**

That concludes our fourth quarter and full year 2012 earnings call. We appreciate your support and look forward to talking with you again in April to discuss our Q1 results.

**Operator**

That concludes the call. Participants may now disconnect.