# iRobot Third-Quarter 2010 Conference Call Script

**October 27, 2010**

**Operator:**

Good day everyone and welcome to the iRobot third-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 and the fourth quarter ending January 1, 2011, seasonality, our longer term expectations regarding gross margin, operating expense margin, operating cash flow and Adjusted EBITDA, our plans for expansion, new product development and shipment and new product distribution channels, backlog and demand for our Government and Industrial robots and related parts and services, orders for our SUGV robots, future levels of product lifecyle revenue, timing and order fulfillment, demand for our home robots, including international demand, mix of product revenue, competitive position and 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 various non-GAAP financial measures as defined by SEC Regulation G, including net income excluding the impact of one-time tax benefit, earnings per share excluding the impact of one-time tax benefit, and Adjusted EBITDA, which we define as Earnings Before Interest, Taxes, Depreciation, Amortization, merger and acquisition expenses and non-cash stock compensation expense. Reconciliations between net income excluding the impact of one-time tax benefit and net income, earnings per share excluding the impact of one-time tax benefit and earnings per share, and net income – the GAAP measure most directly comparable to Adjusted EBITDA - and Adjusted EBITDA are provided in the financial tables at the end of the Q3 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 November 4, 2010 and can be accessed by dialing 617-801-6888, access code 35724357.

On today's call, iRobot Chairman & CEO Colin Angle will provide a review of the company's operations and achievements for the third quarter of 2010 as well as our outlook for the business for the rest of 2010; and John Leahy, Chief Financial Officer, will review our financial results for the third quarter of 2010 and provide our outlook for financial expectations for the fourth quarter ending January 1, 2011 and fiscal 2010. 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.

Our financial performance in the third quarter was exceptionally strong following our record first half results. Revenue was up **20%** from Q3 last year and Adjusted EBITDA for the quarter increased **37%** to **$11** million, far exceeding our expectations. EPS grew **80%** to **$0.18**, excluding the impact of a **$2.3** million one-time tax benefit.

During the quarter we increased our investments in the business, especially in the area of research and development, while also exceeding our financial expectations. For the full year we are raising 2010 revenue expectations once again to **$395** to **$400** million, representing growth of more than **30%** over 2009. We are increasing our expectations for EPS to a range of **$0.80** to **$0.82,** more than six times our 2009 EPS and Adjusted EBITDA to **$46** to **$48** million**,** more than double Adjusted EBITDA last year. Full year earnings per share, excluding the one-time tax benefit are expected to be **$0.72** to **$0.74**.

Profitable growth in the quarter was driven by both divisions. Home robot revenue increased as a result of continuing strong demand in European and Asian markets. Increasing demand for our products continues to outpace concerns about a softening international economy. During the quarter, we also had our first Latin American retail sales, in Chile. Our Government & Industrial Robots division's revenue growth in Q3 was driven by the sale of a significant number of Small Unmanned Ground Vehicles and PackBot® spare parts.

Our continued focus on strengthening the balance sheet resulted in quarter-end cash and investments of **$107** million, up **71%** from **$63** million a year ago. A critical component of improving our cash position over the past year has been through driving Adjusted EBITDA and operating cash flow. Adjusted EBITDA was **$11 million,** or **12%** of revenue, compared with **$8** million in Q3 2009, and we generated **$10** million of operating cash flow in the quarter.

We are having a terrific 2010, on the heels of a strong 2009 and our future looks very exciting. We operate in global markets which are growing and represent multi-billion dollar opportunities. Our continuous commitment to investing in our technology has provided us with a strong, defensible intellectual property portfolio. Ongoing investment in the iRobot brand, coupled with our IP position, gives us a sustainable competitive advantage that will allow us to continue to expand our share of these large and growing markets.

To support my optimism about our growth opportunities, we made some organizational changes during the quarter. We promoted Ret. Vice Admiral Joe Dyer to Chief Operating Officer. Joe had served as President of our G&I division since 2006. Prior to joining iRobot, he served for 32 years in the U.S. Navy in various capacities including program manager for the F/A-18 program and as commander of the **$23** billion NavAir organization. In addition to operationally overseeing our home robot and G&I divisions and healthcare business unit, he will spend more time in Washington advancing our company's interests at a national and congressional level. Joe's new role will also allow me to spend more time focusing on our long term strategy, M&A, pursuing alliances, and new avenues of growth.

Succeeding Joe as President of the G&I division is Knob Moses. Prior to his promotion he was Senior Vice President of the division and had responsibility for managing the division's operations since 2003.

To help ensure our continued position as a leader in delivering robotic technology-based solutions, we are investing in our common software technology plan to drive product generation in the future. To lead that initiative, I've selected Tom Wagner and promoted him to the position of Senior Vice President and Chief Technology Officer from his previous position as Division Technology Officer for G&I.

And finally, we recently announced that Russ Campanello will join iRobot on November 1st as Senior Vice President, Human Resources. Renowned for his expertise on the

strategic role of human resources in business, Russ brings more than 25 years of industry experience and will be responsible for all human resources and organizational development activities at iRobot. He joins the company from PhaseForward following three years as Senior Vice President of HR and Administration and prior to that at Keane, Inc. a $1 billion business process and information technology services firm with more than 10,000 employees worldwide where he served as SVP, HR and Marketing.

By making these changes we are well positioned to continue to carefully manage our growth long into the future.

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

In the Home Robot division, strong demand in international markets, particularly in several European countries and Japan, continued to fuel Home Robot revenue growth. Those markets are proving to be particularly resilient in the face of worldwide macro economic pressures. Home Robot revenue overseas increased almost **60%** year over year. During the quarter, we began our planned penetration of Latin America with initial retail sales in Chile, and expect to have signed distribution agreements in nine countries by year end. To support that sales activity, we recently opened an office in Miami.

In the U.S., we updated our research regarding our domestic target market as part of the refined sales strategy we've discussed in previous calls. We confirmed that the domestic market opportunity is significant, approximately **20** million households, and that our current sales channels are reaching that market. Our target consumers earn above average incomes, want meticulously clean homes and believe that technology can address their floor cleaning problems but need proof that the product will work. Brand trust is also an important part of their purchase process. This refined profile is consistent with that of our international consumers.

A couple of weeks ago, we held a major press event in New York, called Engineering Awesome, to highlight our iAdapt™ navigation technology and Roomba's® vastly

improved power management system. The event marks the first of several North American marketing activities that will extend into 2011. Beginning in the fourth quarter we will kick off a targeted print, radio and on-line media advertising campaign in the U.S., to coincide with holiday shopping.

Revenue in the domestic market declined slightly in the third quarter, due to product availability, following substantial year over-year-growth in the second quarter. We continue to improve domestic home robot profit margins through more strategic placement of product in select channels., In the third quarter, we generated gross margin of **39.7%**, a **9.4** percentage point improvement over last year. We are committed to our strategy of profitable growth, continuing to focus on higher-end products and channels.

Our potential in home robots is tremendous and we have only just begun to penetrate the markets we serve. As we discussed at analyst day, the **annual** worldwide market for vacuum cleaners that cost more than **$200** is **$4 BILLION.** In 2010 we will capture approximately **5%** of that market**.** The robot vacuum cleaner segment of this market is the fastest growing segment and our brand awareness and strong intellectual property position will enable us to continue growing our share of the market.

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Our Government & Industrial Robot division also delivered a very solid quarter as we shipped **186** robots, more than half of which were SUGV 310s. In addition, we recently received an order from the U.S. Air Force for 30 SUGV 310s worth **$4** million. This represents an exciting expansion of our customer base and will provide the Air Force with the capability that our current customers have come to rely on in dealing with dangerous situations in war zones.

Earlier this month we announced a **$14** million order for iRobot Aware®2 robot intelligence software and spare parts to upgrade the U.S. Army's fleet of PackBot FasTac™ robots. When we discussed this opportunity at analyst day, we had expected to upgrade between **500** and **1,000** of these robots in 2010. However, the Army has

since determined that the capabilities afforded the robot through this upgraded software are so compelling they will upgrade their entire inventory of **1,500** FasTac robots over the next several months. This order is **game changing** for both the army and iRobot. The new Aware2 software will enable a completely modular, reconfigurable robot with plug & play payloads and implementation of assistive autonomous operations. The results of this upgrade will be a standardized fleet that can readily accept further upgrades in the future as autonomous capabilities increase and new payloads are developed. And for iRobot, it is an important step in the implementation of our common software strategy.

Beyond supplying robots to the U.S. Government, we continue to expand our international footprint, adding new countries to our growing list of customers. In the third quarter we delivered more than a dozen robots to our existing NATO customers in support of the ongoing missions in Afghanistan. In addition, we saw an increase in the Foreign Military Sales channel with new opportunities in Eastern Europe and the Middle East.

As with our home robot market, the opportunity for our government robots is significant. We have delivered more than **3,500** unmanned ground vehicles, primarily to the U.S. military, principally for use by bomb disposal teams. We are just beginning to see the substantial infantry market opportunity for small unmanned ground vehicles materialize. Over the next 4-7 years we expect orders for these robots to be between **10,000 to 20,000** units or **$1 to $2 BILLION**. More importantly, we have a majority of the current market for this size robot and have proven the defensibility of our intellectual property in this sector. In addition to supplying robots, we expect to continue generating product lifecycle revenue equal to **25%** of product revenue.

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In summary, both of our businesses are performing well and we expect each to grow more than **30%** at the top line in 2010 while contributing a greater percentage to the bottom line. Because of our increased visibility through Q3, we are increasing our expectations for 2010 for the **third** time this year.

For the full year we expect revenue to be between **$395** and **$400** million, EPS to be between **$0.80** and **$0.82**, and Adjusted EBITDA to be between **$46** and **$48** million.

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

**John**

Thanks Colin.

Our performance in the third quarter was outstanding, especially given our very strong first half. Earnings per share and Adjusted EBITDA exceeded expectations while revenue came in at the high end. Revenue grew **20%** year-over-year to **$94** million in the third quarter, driven by continued robust growth in our international Home Robot business, which was up nearly **60%** for the quarter.

Earnings per share for the quarter were **$0.27** compared with **$0.10** in Q3 2009. Excluding the impact of a **$2.3** million tax benefit due to the release of state deferred tax allowances, EPS for the quarter would have been **$0.18**, an **80%** increase over 2009. Adjusted EBITDA was **$11** million for Q3 compared with **$8** million last year. Operating cash flow of **$10** million in the third quarter has driven our cash and investments position to **$107** million, up **$44** million from Q3 last year.

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In the Home Robot division, shipments grew **7%** to **308** thousand units and revenue of **$55** million increased **23%** from a year ago. International revenue increased more than **50%** in the quarter to **$35** million and comprised **64%** of Home Robot revenue. Total domestic revenues decreased approximately **10%** year over year following a **20%** increase in Q2. The production capacity constraints we discussed on the call last quarter impacted domestic revenue as we allocated product across markets. However, we expect Q4 domestic revenue to increase year over year as we enter the holiday season. Home Robot gross margin improvement was due to an increase in international as a percent of total revenue and favorable product and channel mix.

G&I division revenue of **$40** million was up **15%** from a year ago. This growth was driven by higher unit shipments, primarily SUGV 310s, and higher product lifecycle revenue (PLR).

G&I product revenue was **$30** million in the third quarter, compared with **$25** million last year. PLR was **$9** million or **30%** of G&I product revenue, up from **$5** million in 2009.

Product backlog at the end of the quarter was **$34** million, compared with **$12** million at the end of last quarter. This backlog position does not include the recent **$14** million order for Aware®2 upgrades or the **$4** million order from the U.S. Air Force for **30** SUGV 310s. Including these two orders, we now have **100%** visibility of G&I's full year revenue.

For the total company, gross margin for the quarter was **35%** compared with **31%** last year. The improvement was driven primarily by the improved home robot mix I mentioned earlier.

Operating expenses increased slightly as a percentage of revenue, to **27%** from **26%** in Q3 last year, as we doubled our dollar investment in research and development. Some of the sales and marketing expenditures we anticipated making in the third quarter were deferred to the fourth quarter and others were postponed until next year.

Q3 operating cash flow was nearly **$10** million compared with **$13** million last year. Year to date, operating cash flow is **$35** million, or **12%** of revenue.

Inventory was **$34** million at quarter end, up from **$25** million a year ago due to timing of shipments and higher revenues in both divisions. Accounts receivable continue to be well managed, as evidenced by our DSO of **29** days compared with **54** days a year ago.

At the end of Q3, we had cash, including investments, totaling **$107** million compared with **$63** million a year ago.

Now I'd like to provide you with additional detail for the financial expectations Colin discussed.

Our revenue expectations for the full year have increased slightly from last quarter. While we expect both divisions to grow roughly **30%**, international demand for home

robots allows us to increase our expectations for that division to a range of **$223 to $226** million. Our revenue expectations for the G&I division remain at **$172** to **$174** million for the year.

We expect Q4 revenues to be higher than Q3 and our record-setting fourth quarter last year. Home robot revenue will be driven by continued demand from our international customer base. PLR, international orders for PackBots and shipments of SUGV 310s will drive G&I revenue for the fourth quarter.

As we discussed at analyst day, our **3-**year target for gross margin is **35-37%.** We have made significant progress towards that target over the past year and expect full year gross margin of approximately **35%.**

Operating expenses will be higher in Q4 than last year due to marketing program commitments we've made to our international partners and expenditures planned to support and strengthen our brand domestically. We have now added about 130 employees over the past year, largely in R&D and sales.

We expect Q4 to be another strong quarter with revenue in the range of **$108 to $113** million, up almost **10%** from our record quarter last year, EPS of **$0.10 to $0.12** and Adjusted EBITDA in the range of **$8 to $10** million. Our estimated tax rate for Q4 is **39%,** and **31.5%,** for the full year, reflecting the impact of the one-time benefit in Q3.

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

Finally, in 2011 we expect another year of good progress towards our long term financial goals with reasonable top line growth and healthy growth in Adjusted EBITDA and operating cash flow. Given the less seasonal nature of international home robot revenue, the 2011 quarterly revenue pattern is more likely to resemble 2010's than that

of prior years'. G&I's revenue pattern is likely to be lumpier quarter to quarter next year but continue to show solid annual year over year growth.

I'll now turn the call back to Colin.

**Colin**

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

- Revenue of **$395-$400** million
- EPS of **$0.80-$0.82** and
- Adjusted EBITDA of **$46-$48** 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.

iRobot is a market leader in robust, global markets with current annual sales of more than **$4** billion. The size of our markets will continue to grow and we are focused on expanding our share of these markets. We are confident that our strong brand and intellectual property will provide us with a sustainable competitive advantage.

With that we'll take your questions.

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**Following Q&A**

**Colin**

That concludes our third quarter earnings call. We appreciate your support and look forward to talking with you again in February to discuss Q4 results and our financial expectations for 2011.

**Operator -**That concludes the call.  Participants may now disconnect.