

IROBOT CORP  
Form 10-Q  
August 05, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED July 2, 2011  
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER 000-51598  
iROBOT CORPORATION  
(Exact name of registrant as specified in its charter)**

**Delaware  
(State or other jurisdiction of  
incorporation or organization)**

**77-0259 335  
(I.R.S. Employer  
Identification No.)**

**8 Crosby Drive  
Bedford, MA 01730  
(Address of principal executive offices)  
(Zip code)  
(781) 430-3000**

**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

The number of shares outstanding of the Registrant's Common Stock as of July 29, 2011 was 26,857,073.

**iROBOT CORPORATION**  
**FORM 10-Q**  
**THREE AND SIX MONTHS ENDED JULY 2, 2011**  
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**Consolidated Balance Sheets**  
(unaudited)

|  | <b>July 2,<br/>2011</b> | <b>January 1,<br/>2011</b> |
|--|-------------------------|----------------------------|
|  | <b>(in thousands)</b>   |                            |
| <b>ASSETS</b>  |                         |                            |
| Current assets:  |                         |                            |
| Cash and cash equivalents  | \$ 108,725              | \$ 108,383                 |
| Short term investments   | 13,816                  | 13,928                     |
| Accounts receivable, net of allowance of \$88 at July 2, 2011 and January 1, 2011  | 34,529                  | 34,056                     |
| Unbilled revenue   | 8,034                   | 4,012                      |
| Inventory  | 34,202                  | 27,160                     |
| Deferred tax assets  | 13,223                  | 12,917                     |
| Other current assets   | 10,910                  | 6,137                      |
| <b>Total current assets</b>  | <b>223,439</b>          | <b>206,593</b>             |
| Property and equipment, net  | 28,128                  | 25,620                     |
| Deferred tax assets  | 8,733                   | 8,338                      |
| Other assets   | 13,563                  | 13,780                     |
| <b>Total assets</b>  | <b>\$ 273,863</b>       | <b>\$ 254,331</b>          |
| <b>LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK<br/>AND STOCKHOLDERS EQUITY</b>   |                         |                            |
| Current liabilities:   |                         |                            |
| Accounts payable   | \$ 33,273               | \$ 38,689                  |
| Accrued expenses   | 13,854                  | 15,790                     |
| Accrued compensation   | 13,094                  | 17,827                     |
| Deferred revenue and customer advances   | 2,040                   | 3,534                      |
| <b>Total current liabilities</b>   | <b>62,261</b>           | <b>75,840</b>              |
| Long term liabilities  | 3,850                   | 3,584                      |
| Commitments and contingencies (Note 6)   |                         |                            |
| Redeemable convertible preferred stock, 5,000,000 shares authorized and none outstanding   |                         |                            |
| Common stock, \$0.01 par value, 100,000,000 shares authorized; 26,812,164 and 25,844,840 shares issued and outstanding at July 2, 2011 and January 1, 2011, respectively | 268                     | 258                        |
| Additional paid-in capital   | 173,859                 | 156,620                    |
| Retained earnings  | 33,450                  | 17,949                     |
| Accumulated other comprehensive income   | 175                     | 80                         |
| <b>Total stockholders equity</b>   | <b>207,752</b>          | <b>174,907</b>             |
| <b>Total liabilities, redeemable convertible preferred stock and stockholders equity</b>   | <b>\$ 273,863</b>       | <b>\$ 254,331</b>          |

The accompanying notes are an integral part of the consolidated financial statements.



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**Consolidated Statements of Operations**  
**(in thousands, except per share amounts)**  
**(unaudited)**

|   | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|---|---------------------------|-------------------------|-------------------------|-------------------------|
|   | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> |
| <b>Revenue:</b>                                 |                           |                         |                         |                         |
| Product revenue                                 | \$ 97,396                 | \$ 85,945               | \$ 194,107              | \$ 172,056              |
| Contract revenue                                | 10,686                    | 11,859                  | 20,252                  | 20,678                  |
| Total revenue                                   | 108,082                   | 97,804                  | 214,359                 | 192,734                 |
| <b>Cost of revenue:</b>                         |                           |                         |                         |                         |
| Cost of product revenue (1)                     | 57,835                    | 55,825                  | 114,025                 | 111,425                 |
| Cost of contract revenue (1)                    | 7,711                     | 8,009                   | 14,344                  | 14,622                  |
| Total cost of revenue                           | 65,546                    | 63,834                  | 128,369                 | 126,047                 |
| Gross margin                                    | 42,536                    | 33,970                  | 85,990                  | 66,687                  |
| <b>Operating expenses:</b>                      |                           |                         |                         |                         |
| Research and development (1)                    | 8,146                     | 5,691                   | 16,875                  | 10,190                  |
| Selling and marketing (1)                       | 12,767                    | 10,581                  | 25,748                  | 20,225                  |
| General and administrative (1)                  | 10,097                    | 9,313                   | 20,697                  | 17,789                  |
| Total operating expenses                        | 31,010                    | 25,585                  | 63,320                  | 48,204                  |
| Operating income                                | 11,526                    | 8,385                   | 22,670                  | 18,483                  |
| Other income, net                               | 112                       | 40                      | 350                     | 69                      |
| Income before income taxes                      | 11,638                    | 8,425                   | 23,020                  | 18,552                  |
| Income tax expense                              | 3,614                     | 3,111                   | 7,519                   | 7,070                   |
| Net income                                      | \$ 8,024                  | \$ 5,314                | \$ 15,501               | \$ 11,482               |
| Net income per share                            |                           |                         |                         |                         |
| Basic   | \$ 0.30                   | \$ 0.21                 | \$ 0.59                 | \$ 0.46                 |
| Diluted   | \$ 0.29                   | \$ 0.20                 | \$ 0.56                 | \$ 0.44                 |
| Number of shares used in calculations per share |                           |                         |                         |                         |
| Basic   | 26,667                    | 25,294                  | 26,388                  | 25,217                  |
| Diluted   | 27,911                    | 26,375                  | 27,733                  | 26,226                  |

(1) Total stock-based compensation recorded in the three and six months ended July 2, 2011 and July 3, 2010 included in the above figures breaks down by expense classification as follows:

Consolidated Statements of Income

|  | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|--|---------------------------|----------------|-------------------------|----------------|
|  | <b>July 2,</b>            | <b>July 3,</b> | <b>July 2,</b>          | <b>July 3,</b> |

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|                            | <b>2011</b> | <b>2010</b> | <b>2011</b> | <b>2010</b> |
|----------------------------|-------------|-------------|-------------|-------------|
| Cost of product revenue    | \$ 320      | \$ 355      | \$ 571      | \$ 687      |
| Cost of contract revenue   | 156         | 110         | 250         | 236         |
| Research and development   | 239         | 245         | 320         | 277         |
| Selling and marketing      | 158         | 289         | 339         | 645         |
| General and administrative | 1,538       | 1,202       | 2,710       | 2,246       |

The accompanying notes are an integral part of the consolidated financial statements.

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**Consolidated Statements of Cash Flows**  
**(in thousands)**  
**(unaudited)**

|   | <b>Six Months Ended</b> |                         |
|---|-------------------------|-------------------------|
|   | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> |
| <b>Cash flows from operating activities:</b>  |                         |                         |
| Net income  | \$ 15,501               | \$ 11,482               |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                         |                         |
| Depreciation and amortization   | 4,640                   | 3,755                   |
| Loss on disposal of property and equipment  | 473                     | 47                      |
| Stock-based compensation  | 4,190                   | 4,091                   |
| Deferred income taxes, net  | (1,167)                 |                         |
| Non-cash director deferred compensation   | 82                      | 66                      |
| Changes in operating assets and liabilities (use) source                                    |                         |                         |
| Accounts receivable   | (473)                   | 8,038                   |
| Unbilled revenue  | (4,022)                 | (482)                   |
| Inventory   | (7,042)                 | 1,722                   |
| Other assets  | (4,809)                 | 797                     |
| Accounts payable  | (5,416)                 | 1,209                   |
| Accrued expenses  | (1,889)                 | (1,031)                 |
| Accrued compensation  | (4,733)                 | (2,372)                 |
| Deferred revenue  | (1,494)                 | (1,939)                 |
| Long term liabilities   | 266                     | (215)                   |
| Net cash provided by (used in) operating activities   | (5,893)                 | 25,168                  |
| <b>Cash flows from investing activities:</b>  |                         |                         |
| Additions of property and equipment   | (7,208)                 | (5,668)                 |
| Purchases of investments  | (5,000)                 | (25,411)                |
| Sales of investments  | 5,000                   | 7,500                   |
| Net cash used in investing activities   | (7,208)                 | (23,579)                |
| <b>Cash flows from financing activities:</b>  |                         |                         |
| Proceeds from stock option exercises  | 8,597                   | 1,927                   |
| Income tax withholding payment associated with restricted stock vesting                     | (809)                   | (279)                   |
| Tax benefit of excess stock-based compensation deductions                                   | 5,655                   | 717                     |
| Net cash provided by financing activities   | 13,443                  | 2,365                   |
| Net increase in cash and cash equivalents   | 342                     | 3,954                   |
| Cash and cash equivalents, at beginning of period   | 108,383                 | 71,856                  |
| Cash and cash equivalents, at end of period   | \$ 108,725              | \$ 75,810               |
| <b>Supplemental disclosure of cash flow information:</b>                                    |                         |                         |



|                            |          |          |
|----------------------------|----------|----------|
| Cash paid for income taxes | \$ 7,792 | \$ 7,726 |
|----------------------------|----------|----------|

**Supplemental disclosure of noncash investing and financing activities:**

During the six months ended July 2, 2011 and July 3, 2010, the Company transferred \$572 and \$1,352, respectively, of inventory to fixed assets.

The accompanying notes are an integral part of the consolidated financial statements.

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Notes To Consolidated Financial Statements  
(unaudited)

**1. Description of Business**

iRobot Corporation ( iRobot or the Company ) develops robotics and artificial intelligence technologies and applies these technologies in producing and marketing robots. The majority of the Company's revenue is generated from product sales and government and industrial research and development contracts.

The Company is subject to risks common to companies in high-tech industries including, but not limited to, uncertainty of progress in developing technologies, new technological innovations, dependence on key personnel, protection of proprietary technology, compliance with government regulations, uncertainty of market acceptance of products, the need to obtain financing, if necessary, global economic conditions and associated impact on consumer spending, and changes in policies and spending priorities of the U.S. federal government and other government agencies.

**2. Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying consolidated financial statements include those of iRobot and its subsidiaries, after elimination of all intercompany accounts and transactions. iRobot has prepared the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial data as of July 2, 2011 and for the three and six months ended July 2, 2011 and July 3, 2010 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto included in its Annual Report on Form 10-K for the fiscal year ended January 1, 2011, filed with the SEC on February 18, 2011.

In the opinion of management, all adjustments necessary to state fairly its statement of financial position as of July 2, 2011 and results of operations and cash flows for the periods ended July 2, 2011 and July 3, 2010 have been made. The results of operations and cash flows for any interim period are not necessarily indicative of the operating results and cash flows for the full fiscal year or any future periods.

***Use of Estimates***

The preparation of these financial statements in conformity with accounting principles generally accepted in the United States requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates and judgments, including those related to revenue recognition, sales returns, bad debts, warranty claims, inventory reserves, valuation of investments, assumptions used in valuing stock-based compensation instruments and income taxes. The Company bases these estimates on historical and anticipated results, and trends and on various other assumptions that the Company believes are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from the Company's estimates.

***Fiscal Year-End***

The Company operates and reports using a 52-53 week fiscal year ending on the Saturday closest to December 31. Accordingly, the Company's fiscal quarters end on the Saturday that falls closest to the last day of the third month of each quarter.

**Table of Contents**Notes To Consolidated Financial Statements (Continued)  
(unaudited)***Revenue Recognition***

The Company derives its revenue from product sales, government research and development contracts, and commercial research and development contracts. The Company sells products directly to customers and indirectly through resellers and distributors. The Company recognizes revenue from sales of home robots under the terms of the customer agreement upon transfer of title and risk of loss to the customer, net of estimated returns, provided that collection is determined to be reasonably assured and no significant obligations remain. Sales to resellers are typically subject to agreements allowing for limited rights of return for defective products only, rebates and price protection. The Company has typically not taken product returns except for defective products. Accordingly, the Company reduces revenue for its estimates of liabilities for these rights at the time the related sale is recorded. The Company makes an estimate of sales returns for products sold by resellers directly based on historical returns experience and other relevant data. The Company's international distributor agreements do not currently allow for product returns and, as a result, no reserve for returns is established for this group of customers. The Company has aggregated and analyzed historical returns from resellers and end users which form the basis of its estimate of future sales returns by resellers or end users. When a right of return exists, the provision for these estimated returns is recorded as a reduction of revenue at the time that the related revenue is recorded. If actual returns differ significantly from its estimates, such differences could have a material impact on the Company's results of operations for the period in which the returns become known. The estimates for returns are adjusted periodically based upon historical rates of returns. The estimates and reserve for rebates and price protection are based on specific programs, expected usage and historical experience. Actual results could differ from these estimates.

Under cost-plus-fixed-fee ( CPFF ) type contracts, the Company recognizes revenue based on costs incurred plus a pro rata portion of the total fixed fee. Costs incurred include labor and material that are directly associated with individual CPFF contracts plus indirect overhead and general and administrative type costs based upon billing rates submitted by the Company to the Defense Contract Management Agency ( DCMA ). Annually, the Company submits final indirect billing rates to DCMA based upon actual costs incurred throughout the year. These final billing rates are subject to audit by the Defense Contract Audit Agency ( DCAA ) which can occur several years after the final billing rates are submitted and may result in material adjustments to revenue recognized based on estimated final billing rates. As of July 2, 2011, fiscal years 2007, 2008, 2009 and 2010 are open for audit by DCAA. In the situation where the Company's anticipated actual billing rates will be lower than the provisional rates currently in effect, the Company records a cumulative revenue adjustment in the period in which the rate differential is identified. Revenue on firm fixed price ( FFP ) contracts is recognized using the percentage-of-completion method. For government product FFP contracts revenue is recognized as the product is shipped or in accordance with the contract terms. Costs and estimated gross margins on contracts are recorded as revenue as work is performed based on the percentage that incurred costs compare to estimated total costs utilizing the most recent estimates of costs and funding. Changes in job performance, job conditions, and estimated profitability, including those arising from final contract settlements and government audit, may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Since many contracts extend over a long period of time, revisions in cost and funding estimates during the progress of work have the effect of adjusting earnings applicable to past performance in the current period. When the current contract estimate indicates a loss, a provision is made for the total anticipated loss in the current period. Revenue earned in excess of billings, if any, is recorded as unbilled revenue. Billings in excess of revenue earned, if any, are recorded as deferred revenue.

***Accounting for Share-Based Payments***

The Company accounts for share-based payments to employees, including grants of employee stock options and awards in the form of restricted shares and restricted stock units by establishing the fair value of each option grant using the Black-Scholes option- pricing model and the fair value of awards based on stock price at the time of grant. The fair value of share-based payments is recorded by the Company as a charge against earnings. The Company recognizes share-based payment expense over the requisite service period of the underlying grants and awards. The Company's share-based payment awards are accounted for as equity instruments.

**Net Income Per Share**

The following table presents the calculation of both basic and diluted net income per share:

|   | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|---|---------------------------|-------------------------|-------------------------|-------------------------|
|   | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> |
| Net income  | \$ 8,024                  | \$ 5,314                | \$ 15,501               | \$ 11,482               |
| Weighted-average shares outstanding                             | 26,667                    | 25,294                  | 26,388                  | 25,217                  |
| Dilutive effect of employee stock options and restricted shares | 1,244                     | 1,081                   | 1,345                   | 1,009                   |
| Diluted weighted-average shares outstanding                     | 27,911                    | 26,375                  | 27,733                  | 26,226                  |
| Basic income per share  | \$ 0.30                   | \$ 0.21                 | \$ 0.59                 | \$ 0.46                 |
| Diluted income per share  | \$ 0.29                   | \$ 0.20                 | \$ 0.56                 | \$ 0.44                 |

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**Table of Contents**Notes To Consolidated Financial Statements (Continued)  
(unaudited)

Potentially dilutive securities representing approximately 0.4 million and 1.0 million shares of common stock for the three month periods ended July 2, 2011 and July 3, 2010, respectively, and approximately 0.4 million and 1.1 million shares of common stock for the six month periods ended July 2, 2011 and July 3, 2010, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

**Income Taxes**

Deferred taxes are determined based on the difference between the book and tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Valuation allowances are provided, if based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

At July 2, 2011, the Company had total deferred tax assets of \$22.0 million.

The Company has projected an effective 2011 income tax rate of 33%. The Company has recorded a tax provision of \$3.6 million for the three month period ended July 2, 2011, which reflects the projected 2011 tax rate. This \$3.6 million expense compares to \$3.1 million tax expense for the three months ended July 3, 2010 based on a projected effective 2010 income tax rate of 38%. The Company has recorded a tax provision of \$7.5 million for the six month period ended July 2, 2011, which reflects the projected 2011 tax rate. This \$7.5 million expense compares to \$7.1 million tax expense for the six months ended July 3, 2010 based on a projected effective 2010 income tax rate of 38%. This decrease in the projected annual effective tax rate was primarily due to the benefit of research and development tax credits anticipated in 2011 as compared to fiscal 2010 when this credit was not approved by the U.S. federal government until the fourth quarter, and lower anticipated state tax, net of federal benefit.

The Company is currently exploring alternative tax strategies related to research and development credits and Section 199 manufacturing deductions and may record additional benefits in future periods as a result of this evaluation. In connection with the recording of any additional tax benefits, the Company will also assess the need to establish any associated reserves for uncertain tax positions and will record such reserves as appropriate.

**Comprehensive Income**

Comprehensive income includes unrealized losses on certain investments. The differences between net income and comprehensive income were as follows:

|  | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|--|---------------------------|-------------------------|-------------------------|-------------------------|
|  | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> |
| Net income, as reported                      | \$ 8,024                  | \$ 5,314                | \$ 15,501               | \$ 11,482               |
| Unrealized losses on investments, net of tax | 121                       | 124                     | 95                      | 77                      |
| Total comprehensive income                   | \$ 8,145                  | \$ 5,438                | \$ 15,596               | \$ 11,559               |

**Fair Value Measurements**

The authoritative guidance for fair value establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The Company's assets measured at fair value on a recurring basis at July 2, 2011, were as follows:

| <b>Description</b> | <b>Fair Value Measurements as of July 2, 2011</b> |                |                |
|--------------------|---|----------------|----------------|
|                    | <b>Level 1</b>                                    | <b>Level 2</b> | <b>Level 3</b> |

|                                     |          | <b>(In<br/>thousands)</b> |        |
|-------------------------------------|----------|---------------------------|--------|
| Assets:                             |          |                           |        |
| Money Market Funds                  | \$ 5,274 | \$                        | \$     |
| U.S. Government bonds               |          |                           | 2,516  |
| Corporate bonds                     |          |                           | 11,300 |
| Total assets measured at fair value | \$ 5,274 | \$                        | 13,816 |

**Table of Contents**Notes To Consolidated Financial Statements (Continued)  
(unaudited)

The Company's assets measured at fair value on a recurring basis at January 1, 2011, were as follows:

| Description                         | Fair Value Measurements as of January 1,<br>2011 |                              |         |
|-------------------------------------|--|------------------------------|---------|
|                                     | Level 1  | Level 2<br>(In<br>thousands) | Level 3 |
| Assets:                             |  |                              |         |
| Money Market Funds                  | \$ 5,090   | \$                           | \$      |
| U.S. Government bonds               |  | 2,504                        |         |
| Corporate bonds                     |  | 11,424                       |         |
| Total assets measured at fair value | \$ 5,090   | \$ 13,928                    | \$      |

In each table above, the bond investments are valued based on observable market inputs as of the Company's reporting date and are included in Level 2 inputs. In determining the fair value of our Level 2 bond investments, the Company considers the appropriateness of a model and assumptions used by a pricing vendor to price the investments. The pricing vendor's model relies on a comprehensive multi-dimensional relational model that uses standard inputs including benchmark yields, reported trades, broker/dealer quotes, issue spreads, two-sided markets, benchmark securities, bids, offers and reference data including market research publications. The bond investments are recorded at fair value and marked-to-market at the end of each reporting period and realized and unrealized gains and losses are included in comprehensive income (loss) for that period. The fair value of the Company's bond investments are included in short term investments in its consolidated balance sheet.

**Goodwill**

Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. The Company tests goodwill for impairment at the reporting unit level (operating segment or one level below an operating segment) annually or more frequently if the Company believes indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, the Company performs the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill.

**Recent Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board (FASB) issued amended guidance on fair value measurement and related disclosures. The new guidance clarifies the concepts applicable for fair value measurement of non-financial assets and requires the disclosure of quantitative information about the unobservable inputs used in a fair value measurement. This guidance will be effective for reporting periods beginning after December 15, 2011, and will be applied prospectively. The Company does not anticipate a material impact on its consolidated financial statements as a result of the adoption of this amended guidance.

In June 2011, the FASB amended its accounting guidance on the presentation of other comprehensive income (OCI) in an entity's financial statements. The amended guidance eliminates the option to present the components of OCI as part of the statement of changes in shareholders equity and provides two options for presenting OCI: in a statement included in the income statement or in a separate statement immediately following the income statement. The amendments do not change the guidance for the items that have to be reported in OCI or when an item of OCI has to be moved into net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company does not anticipate that its adoption of this

guidance will have a material impact on its consolidated results.

From time to time, new accounting pronouncements are issued by FASB that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of recently issued standards, which are not yet effective, will not have a material impact on the Company's consolidated financial statements upon adoption.

**3. Inventory**

Inventory consists of the following:

|                 | <b>July 2,<br/>2011</b> | <b>January 1,<br/>2011</b> |
|-----------------|-------------------------|----------------------------|
|                 | <b>(In thousands)</b>   |                            |
| Raw materials   | \$ 7,946                | \$ 6,723                   |
| Work in process | 28                      | 27                         |
| Finished goods  | 26,228                  | 20,410                     |
|                 | <b>\$ 34,202</b>        | <b>\$ 27,160</b>           |



**Table of Contents**Notes To Consolidated Financial Statements (Continued)  
(unaudited)**4. Stock Option Plans**

The Company has options outstanding under three stock incentive plans: the 1994 Stock Option Plan (the 1994 Plan), the 2004 Stock Option and Incentive Plan (the 2004 Plan) and the 2005 Stock Option and Incentive Plan (the 2005 Plan) and together with the 1994 Plan and the 2004 Plan, the Plans). The 2005 Plan is the only one of the three plans under which new awards may currently be granted. Under the 2005 Plan, which became effective October 10, 2005, 1,583,682 shares were initially reserved for issuance in the form of incentive stock options, non-qualified stock options, stock appreciation rights, deferred stock awards and restricted stock awards. Additionally, the 2005 Plan provides that the number of shares reserved and available for issuance under the plan will automatically increase each January 1, beginning in 2007, by 4.5% of the outstanding number of shares of common stock on the immediately preceding December 31. Stock options returned to the Plans as a result of their expiration, cancellation or termination are automatically made available for issuance under the 2005 Plan. Eligibility for incentive stock options is limited to those individuals whose employment status would qualify them for the tax treatment associated with incentive stock options in accordance with the Internal Revenue Code of 1986, as amended. As of July 2, 2011, there were 2,684,629 shares available for future grant under the 2005 Plan.

Options granted under the Plans are subject to terms and conditions as determined by the compensation committee of the board of directors, including vesting periods. Options granted under the Plans are exercisable in full at any time subsequent to vesting, generally vest over periods from zero to five years, and expire seven or ten years from the date of grant or, if earlier, 60 or 90 days from employee termination. The exercise price of incentive stock options is equal to the closing price on the NASDAQ Global Market on the date of grant. The exercise price of nonstatutory options may be set at a price other than the fair market value of the common stock.

On July 1, 2011, the Company granted one member of the Board of Directors 6,118 restricted stock units in connection with the commencement of her appointment. These restricted stock units will vest 25% on each anniversary of the grant date. Also on July 1, 2011, the Company granted each of its nine non-employee board members 3,059 restricted stock units. These restricted stock units will vest 100% on the first anniversary of the grant.

**5. Accrued Expenses**

Accrued expenses consist of the following:

|                                  | <b>July 2,<br/>2011</b> | <b>January 1,<br/>2011</b> |
|----------------------------------|-------------------------|----------------------------|
|                                  | <b>(In thousands)</b>   |                            |
| Accrued warranty                 | \$ 9,472                | \$ 9,284                   |
| Accrued direct fulfillment costs | 953                     | 2,405                      |
| Accrued rent                     | 741                     | 592                        |
| Accrued sales commissions        | 252                     | 432                        |
| Accrued accounting fees          | 549                     | 439                        |
| Accrued other                    | 1,887                   | 2,638                      |
|                                  | <b>\$ 13,854</b>        | <b>\$ 15,790</b>           |

**6. Commitments and Contingencies****Lease Obligations**

Rental expense under operating leases for the three months ended July 2, 2011 and July 3, 2010 were \$1.0 million and \$0.9 million, respectively, and for the six months ended July 2, 2011 and July 3, 2010 were \$2.0 million and \$1.8 million, respectively. Future minimum rental payments under operating leases were as follows as of July 2, 2011:

**Operating  
Leases**

|                              | <b>(In<br/>thousands)</b> |
|------------------------------|---------------------------|
| Remainder of 2011            | \$ 1,439                  |
| 2012                         | 2,654                     |
| 2013                         | 2,467                     |
| 2014                         | 2,448                     |
| 2015                         | 2,442                     |
| Thereafter                   | 10,327                    |
| Total minimum lease payments | \$ 21,777                 |

**Table of Contents**Notes To Consolidated Financial Statements (Continued)  
(unaudited)**Sales Taxes**

The Company collects and remits sales tax in jurisdictions in which it has a physical presence or it believes nexus exists, which therefore obligates the Company to collect and remit sales tax. The Company continually evaluates whether it has established a nexus in new jurisdictions with respect to sales tax. The Company has recorded a liability for potential exposure in several states where there is uncertainty about the point in time at which the Company established a sufficient business connection to create nexus. The Company continues to analyze possible sales tax exposure, but does not currently believe that any individual claim or aggregate claims that might arise will ultimately have a material effect on its consolidated results of operations, financial position or cash flows.

**Guarantees and Indemnification Obligations**

The Company enters into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, the Company indemnifies and agrees to reimburse the indemnified party for losses incurred by the indemnified party, generally the Company's customers, in connection with any patent, copyright, trade secret or other proprietary right infringement claim by any third party with respect to the Company's products. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of July 2, 2011 and January 1, 2011, respectively.

**Warranty**

The Company provides warranties on most products and has established a reserve for warranty based on identified or estimated warranty costs. The reserve is included as part of accrued expenses (Note 5) in the accompanying balance sheets.

Activity related to the warranty accrual was as follows:

|                                | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|--------------------------------|---------------------------|-------------------------|-------------------------|-------------------------|
|                                | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> |
|                                | <b>(In thousands)</b>     |                         | <b>(In thousands)</b>   |                         |
| Balance at beginning of period | \$ 9,670                  | \$ 6,840                | \$ 9,284                | \$ 6,105                |
| Provision                      | 932                       | 1,351                   | 2,265                   | 3,095                   |
| Warranty usage(1)              | (1,130)                   | (796)                   | (2,077)                 | (1,805)                 |
| Balance at end of period       | \$ 9,472                  | \$ 7,395                | \$ 9,472                | \$ 7,395                |

(1) Warranty usage includes the expiration of product warranties unutilized.

**7. Industry Segment, Geographic Information and Significant Customers**

The Company operates in two reportable segments, the home robots division and government and industrial division. The nature of products and types of customers for the two segments vary significantly. As such, the segments are managed separately.

**Home Robots**

The Company's home robots division offers products to consumers through a network of retail businesses throughout the United States, to various countries through international distributors and retailers, and through the Company's on-line store. The Company's home robots division includes mobile robots used in the maintenance of domestic households.

**Government and Industrial**

The Company's government and industrial division offers products through a small U.S. government-focused sales force, while products are sold to a limited number of countries, other than the United States, primarily through international distributors but also through a small internationally focused sales team. The Company's government and industrial robots are used by various U.S. and foreign governments, primarily for reconnaissance and bomb disposal missions.

**Table of Contents**Notes To Consolidated Financial Statements (Continued)  
(unaudited)

The table below presents segment information about revenue, cost of revenue, gross margin and income before income taxes:

|                                   | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|-----------------------------------|---------------------------|-------------------------|-------------------------|-------------------------|
|                                   | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> |
| <b>Revenue:</b>                   |                           |                         |                         |                         |
| Home Robots                       | \$ 63,892                 | \$ 52,904               | \$ 131,774              | \$ 105,451              |
| Government & Industrial           | 44,190                    | 44,900                  | 82,585                  | 87,283                  |
| Total revenue                     | 108,082                   | 97,804                  | 214,359                 | 192,734                 |
| <b>Cost of revenue:</b>           |                           |                         |                         |                         |
| Home Robots                       | 35,713                    | 32,176                  | 72,701                  | 64,741                  |
| Government & Industrial           | 29,833                    | 31,658                  | 55,668                  | 61,306                  |
| Total cost of revenue             | 65,546                    | 63,834                  | 128,369                 | 126,047                 |
| <b>Gross margin:</b>              |                           |                         |                         |                         |
| Home Robots                       | 28,179                    | 20,728                  | 59,073                  | 40,710                  |
| Government & Industrial           | 14,357                    | 13,242                  | 26,917                  | 25,977                  |
| Total gross margin                | 42,536                    | 33,970                  | 85,990                  | 66,687                  |
| <b>Research and development</b>   | 8,146                     | 5,691                   | 16,875                  | 10,190                  |
| <b>Selling and marketing</b>      | 12,767                    | 10,581                  | 25,748                  | 20,225                  |
| <b>General and administrative</b> | 10,097                    | 9,313                   | 20,697                  | 17,789                  |
| <b>Other income, net</b>          | 112                       | 40                      | 350                     | 69                      |
| <b>Income before income taxes</b> | \$ 11,638                 | \$ 8,425                | \$ 23,020               | \$ 18,552               |

*Geographic Information*

For the three months ended July 2, 2011 and July 3, 2010, sales to non-U.S. customers accounted for 39.1% and 40.2% of total revenue, respectively, and for the six months ended July 2, 2011 and July 3, 2010, sales to non-U.S. customers accounted for 46.8% and 43.0% of total revenue, respectively.

*Significant Customers*

For the three months ended July 2, 2011 and July 3, 2010, U.S. federal government orders, contracts and subcontracts accounted for 31.5% and 42.5% of total revenue, respectively, and for the six months ended July 2, 2011 and July 3, 2010, U.S. federal government orders, contracts and subcontracts accounted for 30.2% and 39.8% of total revenue, respectively. For the three and six months ended July 2, 2011, the Company generated 7.1% and 9.9%, respectively, of total revenue from The Boeing Company as a subcontractor under U.S. federal government contracts. For the three and six months ended July 2, 2011, the Company generated 10.4% and 10.0%, respectively, of total revenue from its Japanese distributor of home robot products.

**8. Goodwill and Other Intangible Assets**

The carrying amount of the goodwill at July 2, 2011 of \$7.9 million is from the acquisition of Nekton Research, LLC completed in September 2008.

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Other intangible assets include the value assigned to completed technology, research contracts, and a trade name. The estimated useful lives for all of these intangible assets are two to ten years. The intangible assets are being amortized on a straight-line basis, which is consistent with the pattern that the economic benefits of the intangible assets are expected to be utilized.

Intangible assets at July 2, 2011 and January 1, 2011 consisted of the following:

|                      | <b>July 2, 2011</b>   |                                     |            | <b>January 1, 2011</b> |                                     |            |
|----------------------|-----------------------|-------------------------------------|------------|------------------------|-------------------------------------|------------|
|                      | <b>Cost</b>           | <b>Accumulated<br/>Amortization</b> | <b>Net</b> | <b>Cost</b>            | <b>Accumulated<br/>Amortization</b> | <b>Net</b> |
|                      | <b>(In thousands)</b> |                                     |            |                        |                                     |            |
| Completed technology | \$ 3,700              | \$ 1,048                            | \$ 2,652   | \$ 3,700               | \$ 865                              | \$ 2,835   |
| Research contracts   | 100                   | 100                                 |            | 100                    | 100                                 |            |
| Tradename            | 700                   | 199                                 | 501        | 700                    | 165                                 | 535        |
| Total                | \$ 4,500              | \$ 1,347                            | \$ 3,153   | \$ 4,500               | \$ 1,130                            | \$ 3,370   |

**Table of Contents**Notes To Consolidated Financial Statements (Continued)  
(unaudited)

Amortization expense related to acquired intangible assets was \$110,000 and \$220,000 for the three and six months ended July 2, 2011, respectively. The estimated future amortization expense related to current intangible assets in the current fiscal year and each of the four succeeding fiscal years is expected to be as follows:

|                   | <b>(In<br/>thousands)</b> |
|-------------------|---------------------------|
| Remainder of 2011 | \$ 220                    |
| 2012              | 440                       |
| 2013              | 440                       |
| 2014              | 440                       |
| 2015              | 440                       |
| Total             | \$ 1,980                  |

**9. Subsequent Event**

On July 12, 2011, the Company entered into a fifth amendment to its revolving credit facility dated June 5, 2007 and a second amendment to its revolving letter of credit facility dated January 4, 2011. Each of the amendments provide for, among other things:

the revision of the interest rate on loans to between LIBOR plus 1% and LIBOR plus 1.5%, based on the Company's ratio of indebtedness to Adjusted EBITDA;

the extension of the maturity date to June 30, 2014;

the replacement of the minimum tangible net worth covenant with a minimum consolidated net worth covenant; and

the replacement of the minimum Adjusted EBITDA covenant with a minimum ratio of indebtedness to Adjusted EBITDA covenant.

The revolving credit facility amendment also provides for:

the increase of the amount available for borrowing from \$40 million to \$75 million;

the increase of the minimum deposit requirements; and

the increase of the maximum amount the Company can spend on an acquisition without consent of the lender.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion of the financial condition and results of operations of iRobot Corporation should be read in conjunction with the consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended January 1, 2011, which has been filed with the SEC. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the "safe harbor" created by those sections. In particular, statements contained in this Quarterly Report on Form 10-Q, and in the documents incorporated by reference into this Quarterly Report on Form 10-Q, that are not historical facts, including, but not limited to statements concerning new product sales, product development and offerings, Roomba, Scooba, Looj and Verro products, PackBot tactical military robots, the Small Unmanned Ground Vehicle, Seaglider, Negotiator, Ava, our home robot and government and industrial robots divisions, our competition, our strategy, our market position, market acceptance of our products, seasonal factors, revenue recognition, our profits, growth of our revenues, product life cycle revenue, composition of our revenues, our cost of revenues, units shipped, average selling prices, funding of our government and industrial robot development programs, operating expenses, selling and marketing expenses, general and administrative expenses, research and development expenses, and compensation costs, our projected income tax rate, our credit and letter of credit facilities, our valuations of investments, valuation and composition of our stock-based awards, and liquidity, constitute forward-looking statements and are made under these safe harbor provisions. Some of the forward-looking statements can be identified by the use of forward-looking terms such as believes, expects, may, will, should, could, seek, intends, plans, estimates, anticipates, or other comparable terms. Forward-looking statements involve inherent risks and uncertainties which could cause actual results to differ materially from those in the forward-looking statements, including those risks and uncertainties described in our Annual Report on Form 10-K for the year ended January 1, 2011, as well as elsewhere in this Quarterly Report on Form 10-Q. We urge you to consider the risks and uncertainties discussed in our Annual Report on Form 10-K and in Item 1A contained herein in evaluating our forward-looking statements. We have no plan to update our forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made.*

**Overview**

iRobot designs and builds robots that make a difference. For over 20 years, we have developed proprietary technology incorporating advanced concepts in navigation, mobility, manipulation and artificial intelligence to build industry-leading robots. Our Roomba floor vacuuming robot and Scooba floor washing robot perform time-consuming domestic chores in the home, while our Looj gutter cleaning robot and Verro pool cleaning robot perform tasks outside the home. Our PackBot and Small Unmanned Ground Vehicle (SUGV) tactical ground military robots perform battlefield reconnaissance and bomb disposal. Our Negotiator ground robot performs multi-purpose tasks for local police and first responders. Our 1KA Seaglider unmanned underwater robot performs long endurance oceanic missions. We sell our robots to consumers through a variety of distribution channels, including chain stores and other national retailers, and through our on-line store, and to the U.S. military and other government agencies worldwide. We maintain certifications for AS9100 and Capability Maturity Model Integration. These certifications enable us to service our military products and services.

As of July 2, 2011, we had 687 full-time employees. We have developed expertise in the disciplines necessary to build durable, high-performance and cost-effective robots through the close integration of software, electronics and hardware. Our core technologies serve as reusable building blocks that we adapt and expand to develop next generation and new products, reducing the time, cost and risk of product development. Our significant expertise in robot design and engineering, combined with our management team's experience in military and consumer markets, positions us to capitalize on the expected growth in the market for robots.

Although we have successfully launched consumer and government and industrial products, our continued success depends upon our ability to respond to a number of future challenges. We believe the most significant of these



challenges include increasing competition in the markets for both our consumer and government and industrial products, our ability to obtain U.S. federal government funding for research and development programs, and our ability to successfully develop and introduce products and product enhancements.

**Table of Contents****Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and judgments, in particular those related to revenue recognition (specifically sales returns and other allowances); valuation allowances; assumptions used in valuing stock-based compensation instruments; evaluating loss contingencies; and valuation allowances for deferred tax assets. Actual amounts could differ significantly from these estimates. Our management bases its estimates and judgments on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the amounts of revenue and expenses that are not readily apparent from other sources. Additional information about these critical accounting policies may be found in the Management's Discussion and Analysis of Financial Condition and Results of Operations section included in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

**Overview of Results of Operations**

The following table sets forth our results of operations as a percentage of revenue for the three and six month periods ended July 2, 2011 and July 3, 2010:

|                            | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|----------------------------|---------------------------|-------------------------|-------------------------|-------------------------|
|                            | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> |
| Revenue                    |                           |                         |                         |                         |
| Product revenue            | 90.1%                     | 87.9%                   | 90.6%                   | 89.3%                   |
| Contract revenue           | 9.9                       | 12.1                    | 9.4                     | 10.7                    |
| Total revenue              | 100.0                     | 100.0                   | 100.0                   | 100.0                   |
| Cost of revenue            |                           |                         |                         |                         |
| Cost of product revenue    | 53.5                      | 57.1                    | 53.2                    | 57.8                    |
| Cost of contract revenue   | 7.1                       | 8.2                     | 6.7                     | 7.6                     |
| Total cost of revenue      | 60.6                      | 65.3                    | 59.9                    | 65.4                    |
| Gross margin               | 39.4                      | 34.7                    | 40.1                    | 34.6                    |
| Operating expenses         |                           |                         |                         |                         |
| Research and development   | 7.6                       | 5.8                     | 7.9                     | 5.3                     |
| Selling and marketing      | 11.8                      | 10.8                    | 12.0                    | 10.5                    |
| General and administrative | 9.3                       | 9.5                     | 9.6                     | 9.2                     |
| Total operating expenses   | 28.7                      | 26.1                    | 29.5                    | 25.0                    |
| Operating income           | 10.7                      | 8.6                     | 10.6                    | 9.6                     |
| Other income, net          | 0.1                       |                         | 0.1                     |                         |
| Income before income taxes | 10.8                      | 8.6                     | 10.7                    | 9.6                     |
| Income tax expense         | 3.4                       | 3.2                     | 3.5                     | 3.6                     |
| Net income                 | 7.4%                      | 5.4%                    | 7.2%                    | 6.0%                    |

**Comparison of Three and Six Months Ended July 2, 2011 and July 3, 2010****Revenue**

|               | Three Months Ended |                 |                  |                   | Six Months Ended |                 |                  |                   |
|---------------|--------------------|-----------------|------------------|-------------------|------------------|-----------------|------------------|-------------------|
|               | July 2,<br>2011    | July 3,<br>2010 | Dollar<br>Change | Percent<br>Change | July 2,<br>2011  | July 3,<br>2010 | Dollar<br>Change | Percent<br>Change |
| Total revenue | \$ 108,082         | \$ 97,804       | \$ 10,278        | 10.5%             | \$ 214,359       | \$ 192,734      | \$ 21,625        | 11.2%             |

Total revenue for the three months ended July 2, 2011 increased to \$108.1 million, or 10.5%, compared to \$97.8 million for the three months ended July 3, 2010. Revenue increased approximately \$11.0 million, or 20.8%, in our home robots division and decreased approximately \$0.7 million, or 1.6%, in our government and industrial division.

The \$11.0 million increase in revenue from our home robots division for the three months ended July 2, 2011 was driven by an 11.6% increase in units shipped and a 7.5% increase in net average selling price as compared to the three months ended July 3, 2010. In the three months ended July 2, 2011, international home robot revenue increased \$5.8 million and domestic home robot revenue increased \$5.2 million as compared to the three months ended July 3, 2010. Total home robots shipped in the three months ended July 2, 2011 were 328,000 units compared to 294,000 units in the three months ended July 3, 2010. The increase in home robot division revenue and units shipped was attributable to a 30.0% increase in domestic retail sales of our home robot products and a 31.8% increase in domestic direct sales through our website. The increase in domestic retail demand is due primarily to our increased and sustained marketing activities which began in the fourth quarter of 2010 directed at our domestic

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market. The increase in our direct to consumer sales through our website was driven by the introduction of our Roomba 700 series and Scooba 230 robots which to date have only been available on our website. Home robot division revenue from international sales was 64.9% of total home robot division revenue in the three month period ending July 2, 2011 as compared to 67.6% in the three month period ended July 3, 2010. International sales increased 16.1% due to increased demand in our Asian markets, particularly Japan. The increase in demand was driven by marketing programs by our Japanese distributor which include video demonstrations and displays.

The \$0.7 million decrease in revenue from our government and industrial division was driven by a \$3.0 million decrease in product life cycle revenue (spare parts, accessories), and a \$1.2 million decrease in recurring contract development revenue generated under research and development contracts, offset by a \$3.4 million increase in government and industrial robot revenue. The \$3.0 million decrease in product life cycle revenue is due to timing of orders and not indicative of a trend. We expect product life cycle revenue to increase in the second half of 2011 as compared to the prior year due to our increasing installed base of government and industrial robots. The \$1.2 million decrease in recurring contract development revenue generated under research and development contracts was primarily the result of decreases in funding and timing of work efforts for our SUGV and Maritime programs. The \$3.4 million increase in government and industrial robots revenue was primarily due to a 49.0% increase in net average selling prices partially offset by a 23.2% decrease in units shipped in the three month period ended July 2, 2011 as compared to the three month period ended July 3, 2010. The decrease in units shipped is primarily the result of the delayed passage of the U.S. federal government's 2011 fiscal budget. In the second half of 2011 we expect to ship more units than in the prior year. The increase in net average selling price was due to product mix primarily attributable to PackBot and SUGV units with a higher selling price shipped in the three-month period ended July 2, 2011 as compared to lower priced PackBot FasTac units and lower priced configuration of SUGV units shipped in the three-month period ended July 3, 2010. We expect favorable average selling prices to continue during the second half of 2011. Total government and industrial robots shipped in the three months ended July 2, 2011 were 192 units compared to 250 units in the three months ended July 3, 2010.

Total revenue for the six months ended July 2, 2011 increased to \$214.4 million, or 11.2%, compared to \$192.7 million for the six months ended July 3, 2010. Revenue increased approximately \$26.3 million, or 25.0%, in our home robots division and decreased approximately \$4.7 million, or 5.4%, in our government and industrial division.

The \$26.3 million increase in revenue from our home robots division for the six months ended July 2, 2011 was driven by a 16.6% increase in units shipped and a 7.1% increase in net average selling price as compared to the six months ended July 3, 2010. In the six months ended July 2, 2011, international home robot revenue increased \$19.1 million and domestic home robot revenue increased \$7.2 million as compared to the six months ended July 3, 2010. Total home robots shipped in the six months ended July 2, 2011 were 677,000 units compared to 581,000 units in the six months ended July 3, 2010. The increase in home robot division revenue and units shipped was attributable to a 25.4% increase in domestic retail sales of our home robot products and a 13.0% increase in domestic direct sales through our website. The increase in domestic retail demand is due in part to our increased and sustained marketing activities which began in the fourth quarter of 2010 directed at our domestic market. The increase in our direct to consumer sales through our website was driven by the introduction of our Roomba 700 series and Scooba 230 robots which to date have only been available on our website. Home robot division revenue from international sales was 69.3% of total home robot division revenue in the six month period ending July 2, 2011 as compared to 68.5% in the six month period ended July 3, 2010. International sales increased 26.5% due to increased demand in our Asian markets, particularly Japan. The increase in demand is the result of marketing programs implemented by our Japanese distributor which include video demonstrations and displays.

The \$4.7 million decrease in revenue from our government and industrial division was driven by a \$6.1 million decrease in government and industrial robot revenue and a \$0.4 million decrease in recurring contract development revenue generated under research and development contracts offset by a \$1.8 million increase in product life cycle revenue (spare parts, accessories). The \$6.1 million decrease in government and industrial robots revenue was primarily due to a 40.7% decrease in units shipped partially offset by a 48% increase in net average selling prices in the six month period ended July 2, 2011 as compared to the six month period ended July 3, 2010. The decrease in

units shipped is primarily the result of the delayed passage of the U.S. federal government's 2011 fiscal budget. In the second half of 2011 we expect to increase units shipped as compared to the prior year. The increase in net average selling price was due to product mix primarily attributable to PackBot and SUGV units with a higher selling price shipped in the six-month period ended July 2, 2011 as compared to lower priced PackBot FasTac units and lower priced configuration of SUGV units shipped in the six-month period ended July 3, 2010. We expect favorable average selling prices to continue during the second half of 2011. The \$1.8 million increase in product life cycle revenue is the result of a higher installed base of our government and industrial robots. We expect product life cycle revenue will increase in the second half of 2011 as compared to the prior year due to this increasing installed base of government and industrial robots. The \$0.4 million decrease in recurring contract development revenue generated under research and development contracts was primarily the result of decreases in funding and timing of work efforts for our Maritime, PackBot and Research programs offset by an increase in our SUGV programs. Total government and industrial robots shipped in the six months ended July 2, 2011 were 306 units compared to 516 units in the six months ended July 3, 2010.

**Table of Contents***Cost of Revenue*

|                                  | <b>Three Months Ended</b> |                         |                          |                           | <b>Six Months Ended</b> |                         |                          |                           |
|----------------------------------|---------------------------|-------------------------|--------------------------|---------------------------|-------------------------|-------------------------|--------------------------|---------------------------|
|                                  | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
|                                  | <b>(In thousands)</b>     |                         |                          |                           |                         |                         |                          |                           |
| Total cost of revenue            | \$65,546                  | \$63,834                | \$1,712                  | 2.7%                      | \$128,369               | \$126,047               | \$2,322                  | 1.8%                      |
| As a percentage of total revenue | 60.6%                     | 65.3%                   |                          |                           | 59.9%                   | 65.4%                   |                          |                           |

Total cost of revenue increased to \$65.5 million in the three months ended July 2, 2011, compared to \$63.8 million in the three months ended July 3, 2010. The increase is primarily due to the 11.6% increase in home robot units shipped offset by the 23.2% decrease in government and industrial units shipped.

Total cost of revenue increased to \$128.4 million in the six months ended July 2, 2011, compared to \$126.0 million in the six months ended July 3, 2010. The increase is primarily due to the 16.6% increase in home robot units shipped offset by the 40.7% decrease in government and industrial units shipped.

*Gross Margin*

|                                  | <b>Three Months Ended</b> |                         |                          |                           | <b>Six Months Ended</b> |                         |                          |                           |
|----------------------------------|---------------------------|-------------------------|--------------------------|---------------------------|-------------------------|-------------------------|--------------------------|---------------------------|
|                                  | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
|                                  | <b>(In thousands)</b>     |                         |                          |                           |                         |                         |                          |                           |
| Total gross margin               | \$42,536                  | \$33,970                | \$8,566                  | 25.2%                     | \$85,990                | \$66,687                | \$19,303                 | 28.9%                     |
| As a percentage of total revenue | 39.4%                     | 34.7%                   |                          |                           | 40.1%                   | 34.6%                   |                          |                           |

Gross margin increased \$8.6 million, or 25.2%, to \$42.5 million (39.4% of revenue) in the three months ended July 2, 2011 from \$34.0 million (34.7% of revenue) in the three months ended July 3, 2010. The increase in gross margin as a percentage of revenue was the result of the home robots division gross margin increasing 4.9 percentage points and the government and industrial division gross margin increasing 3.0 percentage points. The 4.9 percentage point increase in the home robots division is attributable to changes in customer and product mix to higher margin home robot products including the introduction of our Roomba 700 series and Scooba 230 robots, lower return provisions and warranty expense, and improved leverage of our overhead expense against higher revenue in the three month period ended July 2, 2011 as compared to the three month period ended July 3, 2010. The 3.0 percentage point increase in the government and industrial division is due to product mix primarily attributable to the higher margin PackBot and SUGV units shipped in the current fiscal quarter compared to lower margin PackBot Fastac units and the lower margin configuration of SUGV units shipped in the second quarter of fiscal 2010, and lower warranty expense, partially offset by increased overhead expenses on lower revenue in the three month period ended July 2, 2011 as compared to the three month period ended July 3, 2010.

Gross margin increased \$19.3 million, or 28.9%, to \$86.0 million (40.1% of revenue) in the six months ended July 2, 2011 from \$66.7 million (34.6% of revenue) in the six months ended July 3, 2010. The increase in gross margin as a percentage of revenue was the result of the home robots division gross margin increasing 6.2 percentage points and the government and industrial division gross margin increasing 2.8 percentage points. The 6.2 percentage point increase in the home robots division is attributable to changes in customer and product mix to higher margin home robot products including the introduction of our Roomba 700 series and Scooba 230 robots, improved leverage of our overhead expense against higher revenue, and lower return provisions and warranty expense in the six month period ended July 2, 2011 as compared to the six month period ended July 3, 2010. The 2.8 percentage point increase in the government and industrial division is due to product mix primarily attributable to the higher margin PackBot and SUGV units shipped in the current year compared to lower margin PackBot Fastac units and the lower margin

configuration of SUGV units shipped in the first half of fiscal 2010 and lower warranty expense. Partially offsetting these margin improvements were increased overhead expenses on lower revenue in the six month period ended July 2, 2011 as compared to the six month period ended July 3, 2010.

**Table of Contents***Research and Development*

|                                  | <b>Three Months Ended</b> |                         |                          |                           | <b>Six Months Ended</b> |                         |                          |                           |
|----------------------------------|---------------------------|-------------------------|--------------------------|---------------------------|-------------------------|-------------------------|--------------------------|---------------------------|
|                                  | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
| Total research and development   | \$8,146                   | \$5,691                 | \$2,455                  | 43.1%                     | \$16,875                | \$10,190                | \$6,685                  | 65.6%                     |
| As a percentage of total revenue | 7.6%                      | 5.8%                    |                          |                           | 7.9%                    | 5.3%                    |                          |                           |

Research and development expenses increased by \$2.5 million, or 43.1%, to \$8.1 million (7.6% of revenue) in the three months ended July 2, 2011 from \$5.7 million (5.8% of revenue) for the three months ended July 3, 2010. This was driven by increases in our home robots division of \$1.0 million, government and industrial division of \$1.2 million and other research and development expense of \$0.3 million relating to ongoing development of our common software platform. These increases are due to increases in compensation and benefits, consulting and materials associated with internal research and development projects in both our home robots and government and industrial divisions. The increase in our home robots division is primarily the result of our increased efforts in the areas of new product development. The increase in our government and industrial division is the result of our increased efforts in product development relating to our PackBot, FirstLook, and Warrior programs.

Research and development expenses increased by \$6.7 million, or 65.6%, to \$16.9 million (7.9% of revenue) in the six months ended July 2, 2011 from \$10.2 million (5.3% of revenue) for the six months ended July 3, 2010. This was driven by increases in our home robots division of \$3.7 million, government and industrial division of \$2.7 million and other research and development expense of \$0.3 million relating to ongoing development of our common software platform. These increases are due to increases in compensation and benefits, consulting and materials associated with internal research and development projects in both our home robots and government and industrial divisions. The increase in our home robots division is primarily the result of our increased efforts in the areas of new product development. The increase in our government and industrial division is the result of our increased efforts in product development relating to our PackBot, FirstLook, and Warrior programs.

In addition to our research and development activities classified as research and development expense, we incur research and development expenses under funded development arrangements with governments and industrial third parties. For the three and six months ended July 2, 2011, these expenses amounted to \$7.7 million and \$14.3 million compared to \$8.0 million and \$14.6 million for the three and six months ended July 3, 2010. These expenses have been classified as cost of revenue rather than research and development expense. The combined investment in future technologies, classified as cost of revenue and research and development expense, was \$15.9 million and \$31.2 million for the three and six months ended July 2, 2011, compared to \$13.7 million and \$24.8 million for the three and six months ended July 3, 2010, respectively.

*Selling and Marketing*

|                                  | <b>Three Months Ended</b> |                         |                          |                           | <b>Six Months Ended</b> |                         |                          |                           |
|----------------------------------|---------------------------|-------------------------|--------------------------|---------------------------|-------------------------|-------------------------|--------------------------|---------------------------|
|                                  | <b>July 2,<br/>2011</b>   | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> | <b>July 2,<br/>2011</b> | <b>July 3,<br/>2010</b> | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
| Total selling and marketing      | \$12,767                  | \$10,581                | \$2,186                  | 20.7%                     | \$25,748                | \$20,225                | \$5,523                  | 27.3%                     |
| As a percentage of total revenue | 11.8%                     | 10.8%                   |                          |                           | 12.0%                   | 10.5%                   |                          |                           |

Selling and marketing expenses increased by \$2.2 million, or 20.7%, to \$12.8 million (11.8% of revenue) in the three months ended July 2, 2011 from \$10.6 million (10.8% of revenue) in the three months ended July 3, 2010. This was driven by an increase in our home robots division of \$1.4 million primarily attributable to increases in advertising



targeted toward our domestic market as part of our continued marketing and branding efforts, for the three months ended July 2, 2011 as compared to the three months ended July 3, 2010. Selling and marketing expenses in our government and industrial division increased by \$0.7 million attributable to an increase in compensation and other marketing expenses in the three months ended July 2, 2011 as compared to the three months ended July 3, 2010.

Selling and marketing expenses increased by \$5.5 million, or 27.3%, to \$25.7 million (12.0% of revenue) in the six months ended July 2, 2011 from \$20.2 million (10.5% of revenue) in the six months ended July 3, 2010. This was driven by an increase in our home robots division of \$4.1 million primarily attributable to increases in advertising primarily targeted toward our domestic market as part of our continued marketing and branding efforts, on-line media, other marketing, compensation, and employee-related expense for the six months ended July 2, 2011 as compared to the six months ended July 3, 2010. Selling and marketing expenses in our government and industrial division increased by \$1.2 million attributable to an increase in compensation, trade show, depreciation related to demonstration robots and travel expenses in the six months ended July 2, 2011 as compared to the six months ended July 3, 2010.

**Table of Contents***General and Administrative*

|                                  | Three Months Ended |                 |                                    |                   | Six Months Ended |                 |                  |                   |
|----------------------------------|--------------------|-----------------|------------------------------------|-------------------|------------------|-----------------|------------------|-------------------|
|                                  | July 2,<br>2011    | July 3,<br>2010 | Dollar<br>Change<br>(In thousands) | Percent<br>Change | July 2,<br>2011  | July 3,<br>2010 | Dollar<br>Change | Percent<br>Change |
| Total general and administrative | \$10,097           | \$9,313         | \$784                              | 8.4%              | \$20,697         | \$17,789        | \$2,908          | 16.3%             |
| As a percentage of total revenue | 9.3%               | 9.5%            |                                    |                   | 9.6%             | 9.2%            |                  |                   |

General and administrative expenses increased by \$0.8 million, or 8.4%, to \$10.1 million (9.3% of revenue) in the three months ended July 2, 2011 from \$9.3 million (9.5% of revenue) in the three months ended July 3, 2010. This increase is primarily attributable to increased compensation and employee benefits expenses and stock based compensation expense in the three months ended July 2, 2011 as compared to the three months ended July 3, 2010.

General and administrative expenses increased by \$2.9 million, or 16.3%, to \$20.7 million (9.6% of revenue) in the six months ended July 2, 2011 from \$17.8 million (9.2% of revenue) in the six months ended July 3, 2010. This increase is primarily attributable to increased compensation and employee benefits expenses related to increased headcount, stock based compensation expense, legal expense primarily attributable to our international expansion and intellectual property prosecution and enforcement, and expenses relating to four robots sent to Japan to explore reactor buildings at the Fukushima Daiichi nuclear plant in the six months ended July 2, 2011 as compared to the six months ended July 3, 2010.

*Other Income, Net*

|                                  | Three Months Ended |                 |                                    |                   | Six Months Ended |                 |                  |                   |
|----------------------------------|--------------------|-----------------|------------------------------------|-------------------|------------------|-----------------|------------------|-------------------|
|                                  | July 2,<br>2011    | July 3,<br>2010 | Dollar<br>Change<br>(In thousands) | Percent<br>Change | July 2,<br>2011  | July 3,<br>2010 | Dollar<br>Change | Percent<br>Change |
| Total other income, net          | \$112              | \$40            | \$72                               | Not               | \$350            | \$69            | \$281            | Not               |
| As a percentage of total revenue | 0.1%               | 0.0%            |                                    | Meaningful        | 0.1%             | 0.0%            |                  | Meaningful        |

Other income, net, amounted to \$0.1 million for the three months ended July 2, 2011 compared to \$40,000 for the three months ended July 3, 2010. Other income, net, for the three month period ended July 2, 2011 was related to interest income of \$0.3 million, offset by other expenses of \$0.2 million. Other income, net, for the three month period ended July 3, 2010 was related to interest income of \$0.4 million, offset by other expenses of \$0.3 million.

Other income, net, amounted to \$0.4 million for the six months ended July 2, 2011 compared to \$0.1 million for the six months ended July 3, 2010. Other income, net, for the six month period ended July 2, 2011 was related to interest income of \$0.5 million, offset by other expenses of \$0.2 million. Other income, net, for the six month period ended July 3, 2010 was related to interest income of \$0.4 million, offset by other expenses of \$0.3 million.

*Income Tax Expense*

|                                  | Three Months Ended |                 |                                    |                   | Six Months Ended |                 |                  |                   |
|----------------------------------|--------------------|-----------------|------------------------------------|-------------------|------------------|-----------------|------------------|-------------------|
|                                  | July 2,<br>2011    | July 3,<br>2010 | Dollar<br>Change<br>(In thousands) | Percent<br>Change | July 2,<br>2011  | July 3,<br>2010 | Dollar<br>Change | Percent<br>Change |
| Total income tax expense         | \$3,614            | \$3,111         | \$503                              | 16.2%             | \$7,519          | \$7,070         | \$449            | 6.4%              |
| As a percentage of total revenue | 3.4%               | 3.2%            |                                    |                   | 3.5%             | 3.6%            |                  |                   |

In the three months ended July 2, 2011, we projected an effective 2011 income tax rate of 33%. The tax provision we recorded is \$3.6 million, which reflects the projected 2011 tax rate. This \$3.6 million expense compares to

\$3.1 million tax expense for the three months ended July 3, 2010 based on a projected effective 2010 income tax rate of 38%. The decrease in our projected annual effective tax rate was primarily due to the benefit of research and development tax credits anticipated in 2011 as compared to fiscal 2010 when this credit was not approved by the U.S. federal government until the fourth quarter, and lower anticipated state tax, net of federal benefit.

In the six months ended July 2, 2011, we projected an effective 2011 income tax rate of 33%. The tax provision we recorded is \$7.5 million, which reflects the projected 2011 tax rate. This \$7.5 million expense compares to \$7.1 million tax expense for the six months ended July 3, 2010 based on a projected effective 2010 income tax rate of 38%. The decrease in our projected annual effective tax rate was primarily due to the benefit of research and development tax credits anticipated in 2011 as compared to fiscal 2010 when

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this credit was not approved by the U.S. federal government until the fourth quarter, and lower anticipated state tax, net of federal benefit.

We are currently exploring alternative tax strategies related to research and development credits and Section 199 manufacturing deductions and may record additional benefits in future periods as a result of this evaluation. In connection with the recording of any additional tax benefits, we will also assess the need to establish any associated reserves for uncertain tax positions and will record such reserves as appropriate.

**Liquidity and Capital Resources**

At July 2, 2011, our principal sources of liquidity were cash and cash equivalents totaling \$108.7 million, short-term investments of \$13.8 million and accounts receivable of \$34.5 million.

We manufacture and distribute our products through contract manufacturers and third-party logistics providers. We believe that this approach gives us the advantages of relatively low capital investment and significant flexibility in scheduling production and managing inventory levels. By leasing our office facilities, we also minimize the cash needed for expansion. Accordingly, our capital spending is generally limited to leasehold improvements, computers, office furniture, product-specific production tooling, internal use software and test equipment. In the six months ended July 2, 2011 and July 3, 2010, we spent \$7.2 million and \$5.7 million, respectively, on capital equipment.

Our strategy for delivering products to our distributors and retail customers gives us the flexibility to provide container shipments directly to the retailer from China and, alternatively, allows our distributors and retail partners to take possession of product on a domestic basis. Accordingly, our home robots product inventory consists of goods shipped to our third-party logistics providers for the fulfillment of distributor, retail and direct-to-consumer sales. Our inventory of government and industrial products is relatively low as they are generally built to order. Our contract manufacturers are responsible for purchasing and stocking the majority of components required for the production of our products, and they typically invoice us when the finished goods are shipped.

The balance of cash and short-term investments of \$122.5 million at July 2, 2011 is primarily the result of improving profitability and our significant focus over the past two years on managing working capital. As of July 2, 2011, we did not have any borrowings outstanding under our working capital line of credit and had \$1.7 million in letters of credit outstanding under our revolving letter of credit facility.

***Discussion of Cash Flows***

Net cash used in operating activities for the six months ended July 2, 2011 was \$5.9 million, a decrease of \$31.1 million compared to the \$25.2 million of net cash provided by operating activities for the six months ended July 3, 2010. The decrease in net cash provided by operating activities was primarily driven by the following factors:

An increase in cash of \$4.0 million resulting from net income of \$15.5 million in 2011 versus a net income of \$11.5 million in 2010;

An increase in cash of \$1.3 million resulting from non-cash depreciation and amortization of \$4.6 million and losses on the disposition of fixed assets of \$0.5 million in 2011 versus non-cash depreciation and amortization of \$3.8 million and losses on the disposition of fixed assets of \$47,000 in 2010. The losses on disposition of fixed assets in 2011 relate to four robots sent to Japan to explore reactor buildings at the Fukushima Daiichi nuclear plant;

A decrease in cash of \$12.1 million resulting from an increase in accounts receivable (including unbilled revenue) of \$4.5 million in 2011 versus a decrease of \$7.6 million in 2010, primarily due to growth in revenue and an increase in unbilled revenue related to revenue recorded on contract research and development projects to be invoiced upon DCAA approval of our 2011 provisional indirect cost rates;

A decrease in cash of \$8.8 million resulting from an increase in inventory of \$7.1 million in 2011 versus a decrease of \$1.7 million in 2010, primarily due to increased inventory requirements to support growth in our home robot division revenue and expansion of the home robot product line;

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A decrease in cash of \$5.6 million resulting from an increase in other current assets of \$4.8 million in 2011 versus a decrease of \$0.8 million in 2010 primarily due to an increase in prepaid income taxes including the tax benefit associated with excess stock based compensation deductions;

A decrease in cash of \$6.6 million resulting from an decrease in accounts payable of \$5.4 million in 2011 versus an increase of \$1.2 million in 2010, primarily due to the timing of purchases and payments to suppliers;

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A decrease in cash of \$2.3 million resulting from a decrease in accrued compensation of \$4.7 million in 2011 versus a decrease of \$2.4 million in 2010, primarily due to the impact of improving profitability on the incentive compensation expense in 2010 and related payment in 2011; and

A decrease in cash of \$1.2 million resulting from an increase in deferred tax assets of \$1.2 million in 2011 compared to no change in 2010, primarily due to the recognition of future tax benefits available to us in connection with our latest estimate of tax credits and temporary book-tax differences.

Net cash used in investing activities for the six months ended July 2, 2011 was \$7.2 million, representing a decrease of \$16.4 million compared to the \$23.6 million of net cash used in investing activities for the six months ended July 3, 2010. This decrease in net cash used in investing activities was primarily driven by the following:

Purchase of investments of \$5.0 million, offset by the proceeds from the sale of investments of \$5.0 million in 2011, compared to the purchase of investments, net of the proceeds from the sale of investments, of \$17.9 million in 2010; and

The purchase of property and equipment of \$7.2 million in 2011, compared to \$5.7 million in 2010, primarily due to an increase in self-constructed and demonstration assets, and leasehold improvements associated with expansion of the office space at our headquarters facility.

Net cash provided from financing activities for the six months ended July 2, 2011 was \$13.4 million, an increase of \$11.1 million compared to the \$2.3 million of net cash provided by financing activities for the six months ended July 3, 2010. The increase is due primarily to an increase in proceeds from stock option exercises of \$6.6 million and the tax benefit associated with excess stock based compensation deductions of \$4.9 million.

***Working Capital Facilities***

***Credit Facility***

We have an unsecured revolving credit facility with Bank of America, N.A., which is available to fund working capital and other corporate purposes. As of July 2, 2011, the total amount available for borrowing under our credit facility was \$40.0 million and the full amount was available for borrowing. As of July 2, 2011, the interest on loans under our credit facility accrued, at our election, at either (i) the greater of the BBA LIBOR Daily Floating Rate or the Prime Rate of Lender plus fifty (50) basis points, or (ii) the LIBOR rate plus 1.00%, and the credit facility termination date was June 5, 2012. In connection with the credit facility amendment described under July 2011 Amendments below, the total amount available for borrowing under our credit facility has been increased to \$75.0 million, the interest rate on loans has been amended to between LIBOR plus 1% and LIBOR plus 1.5%, based on our ratio of indebtedness to Adjusted EBITDA, and the termination date has been extended to June 30, 2014.

As of July 2, 2011, we had no outstanding borrowings under our working capital line of credit. This credit facility contains customary terms and conditions for credit facilities of this type, including restrictions on our ability to incur or guaranty additional indebtedness, create liens, enter into transactions with affiliates, make loans or investments, sell assets, pay dividends or make distributions on, or repurchase, our stock, and consolidate or merge with other entities.

In addition, as of July 2, 2011, we were required to meet certain financial covenants customary with this type of agreement, including maintaining a minimum specified tangible net worth, a minimum specified Adjusted EBITDA, and minimum specified interest coverage ratio. In connection with the credit facility amendment described under

July 2011 Amendments below, the minimum tangible net worth and minimum Adjusted EBITDA covenants have been replaced with minimum consolidated net worth and minimum ratio of indebtedness to Adjusted EBITDA covenants.

This credit facility contains customary events of default, including for payment defaults, breaches of representations, breaches of affirmative or negative covenants, cross defaults to other material indebtedness, bankruptcy and failure to discharge certain judgments. If a default occurs and is not cured within any applicable cure period or is not waived, our obligations under the credit facility may be accelerated.

As of July 2, 2011, we were in compliance with all covenants under the revolving credit facility.

***Letter of Credit Facility***

On January 4, 2011, we entered into a revolving letter of credit facility with Bank of America, N.A. The credit facility is available to fund letters of credit on our behalf up to an aggregate outstanding amount of \$5 million. We may terminate or from time to time permanently reduce the amount of the credit facility.

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As of July 2, 2011, we paid a fee on outstanding letters of credit issued under the credit facility equal to 1% per annum of the daily maximum amount available to be drawn under the outstanding letters of credit. In addition, we paid a fee equal to 0.25% per annum of the actual daily amount by which the credit facility exceeds the aggregate undrawn amount of all outstanding letters of credit under the credit facility plus the aggregate of all unreimbursed drawings under all letters of credit under the credit facility. As of July 2, 2011, the maturity date for letters of credit issued under the credit facility was no later than seven days prior to June 5, 2012. In connection with the credit facility amendment described under *July 2011 Amendments* below, this date has been extended to June 30, 2014.

As of July 2, 2011, we had letters of credit outstanding of \$1.7 million under our revolving letter of credit facility. The credit facility contains customary terms and conditions for credit facilities of this type, including restrictions on our ability to incur or guaranty additional indebtedness, create liens, enter into transactions with affiliates, make loans or investments, sell assets, pay dividends or make distributions on, or repurchase, its stock, and consolidate or merge with other entities. In addition, as of July 2, 2011, we were required to meet certain financial covenants customary with this type of agreement, including maintaining a minimum specified tangible net worth, a minimum specified Adjusted EBITDA and a minimum specified ratio of EBIT to interest expense. In connection with the credit facility amendment described under *July 2011 Amendments* below, the minimum tangible net worth and minimum Adjusted EBITDA covenants have been replaced with minimum consolidated net worth and minimum ratio of indebtedness to Adjusted EBITDA covenants.

The credit facility also contains customary events of default, including for payment defaults, breaches of representations, breaches of affirmative or negative covenants, cross defaults to other material indebtedness, bankruptcy, and failure to discharge certain judgments. If a default occurs and is not cured within any applicable cure period or is not waived, the lender may accelerate the obligations under the credit facility.

As of July 2, 2011, we were in compliance with all covenants under the revolving letter of credit facility.  
*July 2011 Amendments*

On July 12, 2011, we entered into a fifth amendment to the revolving credit facility dated June 5, 2007 and a second amendment to the revolving letter of credit facility dated January 4, 2011. Each of the amendments provide for, among other things:

the revision of the interest rate on loans to between LIBOR plus 1% and LIBOR plus 1.5%, based on our ratio of indebtedness to Adjusted EBITDA;

the extension of the maturity date to June 30, 2014;

the replacement of the minimum tangible net worth covenant with a minimum consolidated net worth covenant; and

the replacement of the minimum Adjusted EBITDA covenant with a minimum ratio of indebtedness to Adjusted EBITDA covenant.

The revolving credit facility amendment also provides for:

the increase of the amount available for borrowing from \$40 million to \$75 million;

the increase of the minimum deposit requirements; and

the increase of the maximum amount we can spend on an acquisition without consent of the lender.

***Working Capital and Capital Expenditure Needs***

We currently have no material cash commitments, except for normal recurring trade payables, expense accruals and operating leases, all of which we anticipate funding through working capital, funds provided by operating activities and our existing working capital line of credit. We do not currently anticipate significant investment in property, plant and equipment, and we believe that our outsourced approach to manufacturing provides us with flexibility in both managing inventory levels and financing our inventory. We believe our existing cash and cash equivalents, short-term investments, cash provided by operating activities, and funds available through our working



capital line of credit will be sufficient to meet our working capital and capital expenditure needs over at least the  
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next twelve months. In the event that our revenue plan does not meet our expectations, we may eliminate or curtail expenditures to mitigate the impact on our working capital. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our marketing and sales activities, the timing and extent of spending to support product development efforts, the timing of introductions of new products and enhancements to existing products, the acquisition of new capabilities or technologies, and the continuing market acceptance of our products and services. Moreover, to the extent that existing cash and cash equivalents, short-term investments, cash from operations, and cash from short-term borrowing are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. As part of our business strategy, we may consider additional acquisitions of companies, technologies and products, which could also require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

**Contractual Obligations**

We generally do not enter into binding purchase commitments. Our principal commitments consist of obligations under our working capital line of credit, leases for office space and minimum contractual obligations for services and certain components. The following table describes our commitments to settle contractual obligations in cash as of July 2, 2011:

|                              | Less<br>Than<br>1 Year | Payments Due by Period |                 |                         | Total     |
|------------------------------|------------------------|------------------------|-----------------|-------------------------|-----------|
|                              |                        | 1 to 3<br>Years        | 3 to 5<br>Years | More<br>Than<br>5 Years |           |
|                              |                        | (In thousands)         |                 |                         |           |
| Operating leases             | \$ 2,812               | \$ 4,973               | \$ 4,858        | \$ 9,134                | \$ 21,777 |
| Minimum contractual payments | 3,028                  | 2,090                  |                 |                         | 5,118     |
| Other obligations            | 414                    |                        |                 |                         | 414       |
| Total                        | \$ 6,254               | \$ 7,063               | \$ 4,858        | \$ 9,134                | \$ 27,309 |

Our minimum contractual payments consist of payments to our provider of direct fulfillment services for direct to consumer sales of our home robots and payments to a key component supplier for our home robots, which payments are incurred in the ordinary course of business. Based on an analysis of actual and projected fees for 2011, we expect there will be a shortfall between our actual transaction fees and our contractual minimum fees for services. Expense accruals for the proportionate share of these expected shortfalls have been recorded to selling and marketing expense in the three month period ended July 2, 2011. Other obligations consist of software license and services agreement for our home robots division customer service web support.

**Off-Balance Sheet Arrangements**

As of July 2, 2011, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

**Recently Issued Accounting Pronouncements**

See Footnote 2 to the Consolidated Financial Statements for a discussion of recently issued accounting pronouncements.

**Item 3. Quantitative and Qualitative Disclosure About Market Risk****Interest Rate Sensitivity**

At July 2, 2011, we had unrestricted cash and cash equivalents of \$108.7 million and short term investments of \$13.8 million. The unrestricted cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Some of the securities in which we invest, however, may be subject to market risk. This means that a change in prevailing interest rates may cause the fair market value of the investment to fluctuate. To minimize this risk in the future, we intend to maintain our portfolio of cash equivalents in a variety of securities, commercial paper, money market funds, debt securities and certificates of deposit. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. As of July 2, 2011, all of our cash and cash equivalents

were held in interest-bearing demand deposits and money market accounts.

Our exposure to market risk also relates to the increase or decrease in the amount of interest expense we must pay on any outstanding debt instruments, primarily certain borrowings under our working capital line of credit. The advances under the working capital line of credit bear a variable rate of interest determined as a function of the prime rate or the LIBOR rate at the time of the borrowing. At July 2, 2011, we had letters of credit outstanding of \$1.7 million under our revolving letter of credit facility.

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**Exchange Rate Sensitivity**

We maintain sales and business operations in foreign countries. As such, we have exposure to adverse changes in exchange rates associated with operating expenses of our foreign operations, but we believe this exposure to be immaterial. Additionally, we accept orders for home robot products in currencies other than the U.S. dollar. We regularly monitor the level of non-U.S. dollar accounts receivable balances to determine if any actions, including possibly entering into foreign currency forward contracts, should be taken to minimize the impact of fluctuating exchange rates on our results of operations. Our international revenue is primarily denominated in U.S. dollars and therefore any fluctuations in the Euro or any other non-U.S. dollar currencies will have minimal direct impact on our international revenue. However, as the U.S. dollar strengthens or weakens against other currencies, our international distributors may be impacted, which could affect their profitability and our ability to maintain current pricing levels on our international consumer products.

**Item 4. Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective at a reasonable assurance level in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms; and (ii) accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely discussions regarding required disclosure. We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II. Other Information**

**Item 1. Legal Proceedings**

From time to time and in the ordinary course of business, we are subject to various claims, charges and litigation. The outcome of litigation cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavorably to us, which could materially affect our financial condition or results of operations.

**Item 1A. Risk Factors**

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this report, the risks and uncertainties that we believe are most important for you to consider are discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended January 1, 2011, which could materially affect our business, financial condition or future results. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. There are no material changes to the Risk Factors described in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table sets forth the repurchases of our equity securities during the three months ended July 2, 2011 by or on behalf of us or any affiliated purchaser:

| <b>Period</b>   | <b>(a) Total<br/>number<br/>of Shares<br/>(or<br/>Units)<br/>Purchased</b> | <b>(b)<br/>Average<br/>Price<br/>Paid per<br/>Share<br/>(or<br/>Unit)</b> | <b>(c) Total<br/>Number of<br/>Shares (or<br/>Units)<br/>Purchased<br/>as<br/>Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>(d) Maximum<br/>Number (or<br/>Approximate<br/>Dollar<br/>Value) of<br/>Shares (or<br/>Units) that<br/>May Yet<br/>Be Purchased<br/>Under<br/>the Plans or<br/>Programs</b> |
|---|--|---|--|--|
| Fiscal month beginning April 3, 2011 and ended April 30, 2011 | 2,779(1)   | \$ 36.37(2)   |  |  |
| Fiscal month beginning May 1, 2011 and ended May 28, 2011     | 1,390(1)   | \$ 31.58(2)   |  |  |
| Fiscal month beginning May 29, 2011 and ended July 2, 2011    | 6,263(1)   | \$ 33.75(2)   |  |  |
| Total   | 10,432(1)  | \$ 34.16(3)   |  |  |

- (1) Represents shares of our common stock withheld by us to satisfy the minimum tax withholding obligation in connection with the vesting of restricted stock units held by executive officers.
- (2) The amount represents the last reported sale price of our common stock on the NASDAQ Global Market on the applicable vesting date.
- (3) The amount represents the weighted average sale price of all shares of our common stock repurchased during the three months ended July 2, 2011.

**Item 5. Other Information**

Our policy governing transactions in our securities by our directors, officers, and employees permits our officers, directors, funds affiliated with our directors, and certain other persons to enter into trading plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. We have been advised that certain of our officers and directors (including Colin Angle, Chief Executive Officer, Joseph Dyer, Chief Operating Officer, Glen Weinstein, Senior Vice President, General Counsel and Secretary, John Leahy, Chief Financial Officer, Jeffrey Beck, President, Home Robots Division, Robert Moses, President, Government and Industrial Division, and Alison Dean, Senior Vice President of Corporate Finance and Principal Accounting Officer) of the Company have entered into trading plans (each a Plan and collectively, the Plans) covering periods after the date of this quarterly report on Form 10-Q in accordance with Rule 10b5-1 and our policy governing transactions in our securities. Generally, under these trading plans, the individual relinquishes control over the transactions once the trading plan is put into place. Accordingly, sales under these plans may occur at any time, including possibly before, simultaneously with, or immediately after significant events involving our company.

We anticipate that, as permitted by Rule 10b5-1 and our policy governing transactions in our securities, some or all of our officers, directors and employees may establish trading plans in the future. We intend to disclose the names of our executive officers and directors who establish a trading plan in compliance with Rule 10b5-1 and the requirements of our policy governing transactions in our securities in our future quarterly and annual reports on Form 10-Q and 10-K filed with the Securities and Exchange Commission. We, however, undertake no obligation to update or revise the information provided herein.

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**Item 6. Exhibits**

**Exhibit**

**Number**

**Description**

|       |   |
|-------|---|
| 10.1* | Registrant's Senior Executive Incentive Compensation Plan, as amended and restated  |
| 31.1* | Certification Pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934   |
| 31.2* | Certification Pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934   |
| 32.1* | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 101** | The following materials from the Registrant's Quarterly Report on Form 10-Q for the quarter ended July 2, 2011 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Cash Flows, and (iv) related notes to these financial statements |

\* Filed herewith

\*\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934

Indicates a management contract or any compensatory plan, contract or arrangement

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

iROBOT CORPORATION

Date: August 5, 2011

By: /s/ JOHN LEAHY  
John Leahy  
Executive Vice President, Chief  
Financial Officer  
and Treasurer (Duly Authorized Officer  
and Principal Financial Officer)

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