

IROBOT CORP
Form 10-Q
October 31, 2007

Table of Contents

**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 September 29, 2007
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.)**

**63 South Avenue
Burlington, MA 01803
(Address of principal executive offices)
(Zip code)
(781) 345-0200**

(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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 October 27, 2007 was 24,484,211.

iROBOT CORPORATION
FORM 10-Q
THREE AND NINE MONTHS ENDED September 29, 2007
INDEX

	Page
PART I: FINANCIAL INFORMATION	
Item 1. Financial Statements	
<u>Consolidated Balance Sheets as of September 29, 2007 (unaudited) and December 30, 2006</u>	2
<u>Consolidated Statements of Operations for the three and nine month periods ended September 29, 2007 and September 30, 2006 (unaudited)</u>	3
<u>Consolidated Statements of Cash Flows for the nine month periods ended September 29, 2007 and September 30, 2006 (unaudited)</u>	4
<u>Notes to Consolidated Financial Statements (unaudited)</u>	5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3. Quantitative and Qualitative Disclosures about Market Risk	22
Item 4. Controls and Procedures	23
PART II: OTHER INFORMATION	
Item 1. Legal Proceedings	23
Item 1A. Risk Factors	23
Item 5. Other Information	24
Item 6. Exhibits	26
Signatures	27
Exhibit Index	28
<u>EX-31.1 - Section 302 Certification of CEO</u>	
<u>EX-31.2 - Section 302 Certification of CFO</u>	
<u>EX-32.1 - Section 906 Certification of CEO & CFO</u>	

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

Table of Contents

iROBOT CORPORATION
Consolidated Balance Sheets
(in thousands)

	September 29, 2007 (unaudited)	December 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 23,200	\$ 5,583
Short-term investments	26,300	64,800
Accounts receivable, net of allowance of \$65 and \$163 at September 29, 2007 and December 30, 2006, respectively	35,157	28,510
Unbilled revenue	2,757	1,961
Inventory, net	43,711	20,890
Other current assets	2,039	2,863
Total current assets	133,164	124,607
Property and equipment, net	13,120	10,701
Total assets	\$ 146,284	\$ 135,308
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 45,948	\$ 27,685
Accrued expenses	5,101	7,020
Accrued compensation	7,588	5,227
Deferred revenue	1,140	457
Total current liabilities	59,777	40,389
Commitments and contingencies (Note 8):		
Redeemable convertible preferred stock, 5,000 shares authorized and zero outstanding at September 29, 2007 and December 30, 2006		
Common stock, \$0.01 par value, 100,000 and 100,000 shares authorized and 24,479 and 23,791 issued and outstanding at September 29, 2007 and December 30, 2006, respectively	245	238
Additional paid-in capital	119,462	117,718
Deferred compensation	(834)	(2,326)
Accumulated deficit	(32,366)	(20,711)
Total stockholders' equity	86,507	94,919
Total liabilities and stockholders' equity	\$ 146,284	\$ 135,308

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

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	29,	30,	29,	30,
	2007	2006	2007	2006
Revenue:				
Product revenue	\$ 58,667	\$ 48,359	\$ 134,149	\$ 111,309
Contract revenue	5,173	6,688	16,192	16,508
Total revenue	63,840	55,047	150,341	127,817
Cost of revenue:				
Cost of product revenue (1)	39,186	28,398	89,910	69,698
Cost of contract revenue (1)	4,542	3,666	13,978	11,166
Total cost of revenue	43,728	32,064	103,888	80,864
Gross profit	20,112	22,983	46,453	46,953
Operating expenses:				
Research and development (1)	4,739	4,345	13,074	10,946
Selling and marketing (1)	11,115	4,712	30,108	19,197
General and administrative (1)	6,459	4,663	17,538	14,074
Total operating expenses	22,313	13,720	60,720	44,217
Operating income (loss)	(2,201)	9,263	(14,267)	2,736
Other income, net	845	978	2,663	2,847
Income (loss) before income taxes	(1,356)	10,241	(11,604)	5,583
Income tax expense	22	199	51	235
Net income (loss)	\$ (1,378)	\$ 10,042	\$ (11,655)	\$ 5,348
Net income (loss) per share				
Basic	\$ (0.06)	\$ 0.43	\$ (0.48)	\$ 0.23
Diluted	\$ (0.06)	\$ 0.39	\$ (0.48)	\$ 0.21
Number of shares used in per share calculations				
Basic	24,337	23,560	24,156	23,455
Diluted	24,337	25,502	24,156	25,610

(1) Total stock-based compensation recorded in the three and nine

months ended
September 29,
2007 and
September 30,
2006 included
in the above
figures breaks
down by
expense
classification as
follows:

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	29,	30,	29,	30,
	2007	2006	2007	2006
Cost of product revenue	\$ 162	\$ 92	\$ 521	\$ 215
Cost of contract revenue	81	72	292	183
Research and development	134	91	252	271
Selling and marketing	226	133	833	239
General and administrative	627	336	1,517	854
Total stock-based compensation	\$ 1,230	\$ 724	\$ 3,415	\$ 1,762

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

Table of Contents

iROBOT CORPORATION
Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine Months Ended	
	September	September
	29,	30,
	2007	2006
Cash flows from operating activities:		
Net income (loss)	\$ (11,655)	\$ 5,348
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	3,989	2,737
Loss on disposal of fixed assets	48	2
Stock-based compensation	3,415	1,762
Non-cash director deferred compensation	83	
Changes in working capital (use) source		
Accounts receivable	(6,647)	(7,598)
Unbilled revenue	(796)	311
Inventory	(22,821)	(7,921)
Other assets	824	372
Accounts payable	18,263	4,238
Accrued expenses	(1,919)	1,877
Accrued compensation	2,361	1,992
Provision for contract settlement		(5,154)
Deferred revenue	683	1,180
Net cash used in operating activities	(14,172)	(854)
Cash flows from investing activities:		
Purchase of property and equipment	(6,456)	(3,835)
Purchases of investments	(44,750)	(108,150)
Sales of investments	83,250	44,300
Net cash provided by (used in) investing activities	32,044	(67,685)
Cash flows from financing activities:		
Income tax withholding payment associated with stock option exercise	(1,588)	
Proceeds from stock option exercises	1,333	699
Tax benefit of disqualifying dispositions		94
Net cash provided by (used in) financing activities	(255)	793
Net increase (decrease) in cash and cash equivalents	17,617	(67,746)
Cash and cash equivalents, at beginning of period	5,583	76,064

Cash and cash equivalents, at end of period	\$ 23,200	\$ 8,318
---	-----------	----------

Supplemental disclosure of cash flow information:

Cash paid for interest	\$ 30	\$ 13
Cash paid for income taxes	140	164

Supplemental disclosure of noncash investing and financing activities (in thousands):

During the nine months ended September 29, 2007 and September 30, 2006, the Company transferred \$692 and \$697, respectively, of inventory to fixed assets.

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

Table of Contents

iROBOT CORPORATION

Notes To Consolidated Financial Statements
(unaudited)

1. Description of Business

iRobot Corporation (iRobot or the Company) was incorporated in 1990 to develop robotics and artificial intelligence technologies and apply 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 and uncertainty of market acceptance of products.

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.

The accompanying financial data as of September 29, 2007 and for the three and nine months ended September 29, 2007 and September 30, 2006 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. 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 December 30, 2006, filed with the SEC on March 2, 2007.

In the opinion of management, all adjustments necessary to present a fair statement of financial position as of September 29, 2007 and results of operations and cash flows for the periods ended September 29, 2007 and September 30, 2006 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.

Reclassification

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

Table of Contents**iROBOT CORPORATION**

Notes To Consolidated Financial Statements Continued
(unaudited)

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.

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 to the customer, net of estimated returns, provided that collection is determined to be probable and no significant obligations remain. Sales to resellers are 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 or through its distributors based on historical returns experience and other relevant data. 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. In accordance with Statement of Financial Accounting Standards No. 48, *Revenue Recognition When 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. Revenue on firm fixed price (FFP) contracts is recognized using the percentage-of-completion method. Costs and estimated gross profits 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, 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.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R), *Share-Based Payment*, which establishes accounting for the equity instruments exchanged for employee services. Under the provisions of SFAS No. 123(R), the Company establishes the fair value of each option grant using the Black-Scholes option-pricing model. Given the Company's initial public offering in November 2005 and the resulting short history as a public company, the Company could not rely solely on company specific historical data upon the adoption of SFAS No. 123(R) for purposes of establishing an expected volatility assumption for use in applying the Black-Scholes option-pricing model. Consequently, the Company performed an analysis of several peer companies with similar expected option lives to develop an expected volatility assumption of 65% which was utilized for establishing the fair value of all options granted during fiscal 2006.

The Company regularly reviews its volatility assumption utilizing a methodology consistent with that described above that includes a blend of company specific data since its initial public offering and data from the above-mentioned peer companies for a period covering the expected option lives. Based upon these analyses, the

Company established volatility rates for use in calculating the fair value of option grants in the six month period ended June 30, 2007 and the three month period ended September 29, 2007 of 55% and 50%, respectively.

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

These reductions in the volatility rate assumption had the result of establishing lower fair values and, consequently, lower stock-based compensation expense in the current and future periods, for options granted in the nine months ended September 29, 2007.

Upon the adoption of SFAS No. 123(R) on January 1, 2006, the Company assumed a forfeiture rate of 5% for all stock options granted subsequent to its initial public offering with the exception of those issued to executives and directors for which a zero forfeiture rate had been assumed. These rates were in effect for all of fiscal 2006. Effective the beginning of fiscal 2007, the Company established a 2.5% forfeiture rate for executives and directors. In the future, the Company will record incremental stock-based compensation expense if the actual forfeiture rates are lower than estimated and will record a recovery of prior stock-based compensation expense if the actual forfeitures are higher than estimated.

In a review of its stock-based compensation accounting methodology performed during its second fiscal quarter ended June 30, 2007, the Company determined that a cumulative adjustment of \$0.5 million of incremental stock-based compensation expense was required due to a correction in the application of SFAS No. 123(R). Upon adoption of SFAS No. 123(R) on January 1, 2006, the Company incorrectly valued 259,700 stock options that were granted between the date that it filed its initial Form S-1 registration statement with the Securities and Exchange Commission on July 27, 2005 and the date it became a public company (November 8, 2005). The Company believes, in accordance with APB 28, paragraph 29, that this adjustment will not be material to its estimated full year results for 2007. In addition, management does not believe the adjustment is material to the amounts reported by the Company in previous periods. This cumulative adjustment was recorded during the three month period ended June 30, 2007 and is included in the cost of revenue and operating expenses for the nine month period ended September 29, 2007.

Net Income Per Share

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

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	29,	30,	29,	30,
	2007	2006	2007	2006
	(In thousands, except		(In thousands, except	
	per share data)		per share data)	
Net income (loss)	\$ (1,378)	\$ 10,042	\$ (11,655)	\$ 5,348
Weighted average shares outstanding	24,337	23,560	24,156	23,455
Dilutive effect of employee stock options and restricted shares		1,942		2,155
Diluted weighted average shares outstanding	24,337	25,502	24,156	25,610
Basic income (loss) per share	\$ (0.06)	\$ 0.43	\$ (0.48)	\$ 0.23
Diluted income (loss) per share	\$ (0.06)	\$ 0.39	\$ (0.48)	\$ 0.21

Income Taxes

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*, which prescribes a recognition threshold and measurement attribute for

the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Accordingly, the Company adopted FIN 48 beginning December 31, 2006 and the impact of adoption on its opening balance of retained earnings was zero. As of the beginning of fiscal year 2007, the Company had no unrecognized tax benefits and no unrecognized tax benefits were recorded in the nine months ended September 29, 2007. The Company recognizes interest and penalties related to unrecognized tax benefits in its tax provision. There were no accrued interest or penalties as of December 31, 2006 or September 29, 2007.

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

The Company is subject to taxation in the United States and various states and foreign jurisdictions. The Company's United States federal income tax returns for tax years after 1998 are subject to examination by the Internal Revenue Service. The Company's principal state income tax returns for tax years after 2002 are subject to examination by the state tax authorities.

Deferred taxes are determined based on the difference between the financial statement 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.

The Company monitors the realization of its deferred tax assets based on changes in circumstances, such as recurring periods of income for tax purposes following historical periods of cumulative losses or changes in tax laws or regulations. The Company's income tax provisions and its assessment of the realizability of its deferred tax assets involve significant judgments and estimates. If the Company generates taxable income through profitable operations in the future it may be required to recognize these deferred tax assets in the near term through the reduction of the valuation allowance which would result in a material benefit to its results of operations in the period in which the benefit is determined, excluding the recognition of the portion of the valuation allowance that relates to stock compensation windfall tax benefits.

Comprehensive Income

SFAS No. 130, *Reporting Comprehensive Income*, establishes standards for the reporting and display of comprehensive income and its components in financial statements. The Company's comprehensive income is equal to the Company's net income for all periods presented.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of SFAS No. 157 are expected to be effective for fiscal years beginning after November 15, 2007. The Company is currently assessing SFAS No. 157 and has not yet determined the impact, if any, that its adoption will have on its result of operations or financial condition.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose fair value measurement for many financial instruments and certain other items as of specified election dates. Business entities will thereafter report in earnings the unrealized gains and losses on items for which the fair value option has been chosen. The fair value option may be applied instrument by instrument, may not be applied to portions of instruments and is irrevocable unless a new election date occurs. SFAS 159 is effective for an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the potential impact of adoption of SFAS 159 and has not yet determined the impact, if any, that its adoption will have on its result of operations or financial condition.

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. Cash and Cash Equivalents

Cash and cash equivalents include demand deposits, money market accounts, and other highly liquid investments with original maturities of three months or less at the date of acquisition. The Company invests its excess operating

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

cash primarily in money market funds of major financial institutions. Cash equivalents are carried at cost, which approximates fair market value, and interest is accrued as earned.

4. Short-term Investments

The Company's investments are classified as available-for-sale and are recorded at fair value with any unrealized gain or loss recorded as an element of stockholders' equity. The fair value of investments is determined based on quoted market prices at the reporting date for those instruments. As of September 29, 2007, investments consisted of:

	September 29, 2007		December 30, 2006	
	Cost	Fair Market Value	Cost	Fair Market Value
	(In thousands)			
Auction Rate Debt Securities	\$26,300	\$ 26,300	\$64,800	\$ 64,800

As of September 29, 2007, the Company's investments had maturity dates ranging from February 2025 to June 2047. Despite the long-term contractual maturities of the auction rate securities held at September 29, 2007, all of these securities are available for sale and it is the Company's intention to liquidate these securities within one year.

5. Inventory

Inventory consists of the following at:

	September 29, 2007	December 30, 2006
	(In thousands)	
Raw materials	\$ 1,820	\$ 1,248
Work in process	868	311
Finished goods	41,023	19,331
	\$43,711	\$ 20,890

6. Stock Option Plans

The Company has options outstanding under four stock incentive plans: the 1994 Stock Option Plan (the 1994 Plan), the 2001 Special Stock Option Plan (the 2001 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, the 2001 Plan and the 2004 Plan, the Plans). The 2005 Plan is the only one of the four 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. As of September 29, 2007, there were 1,177,150 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 0 to 5 years, and expire 7 or 10 years from the date of grant or,

if earlier, 60 or 90 days from employee termination. Prior to the Company's initial public offering, the exercise price for each incentive stock option was determined by the board of directors of the Company to be equal to the fair value of the common stock on the date of grant. In reaching this determination at the time of each such grant, the board of directors considered a broad range of factors, including the illiquid nature of an investment in the Company's common stock, the Company's historical financial performance, the Company's future

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

prospects and the value of preferred stock based on recent financing activities. Subsequent to the Company's initial public offering 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.

7. Accrued Expenses

Accrued expenses consist of the following at:

	September 29, 2007	December 30, 2006
	(In thousands)	
Accrued warranty	\$ 2,146	\$ 2,462
Accrued direct fulfillment costs	643	2,123
Accrued rent	231	284
Accrued sales commissions	409	502
Accrued accounting fees	465	332
Accrued income taxes	67	168
Accrued other	1,140	1,149
	\$ 5,101	\$ 7,020

8. Commitments and Contingencies***Lease Obligations***

The Company leases its facilities. Rental expense under operating leases for the three months ended September 29, 2007 and September 30, 2006 amounted to \$0.5 million and \$0.5 million, respectively, and for the nine months ended September 29, 2007 and September 30, 2006 amounted to \$1.5 million and \$1.5 million, respectively. Future minimum rental payments under operating leases were as follows as of September 29, 2007:

	Operating Leases (In thousands)
Remainder of 2007	\$ 561
2008	3,205
2009	2,245
2010	2,131
2011	2,112
Thereafter	17,420
Total minimum lease payments	\$ 27,674

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 September 29, 2007 and December 30, 2006, respectively.

Table of Contents**iROBOT CORPORATION**

Notes To Consolidated Financial Statements Continued
(unaudited)

Warranty

The Company provides warranties on most products and has established a reserve for warranty based on identified warranty costs. The reserve is included as part of accrued expenses (Note 7) in the accompanying balance sheets.

Activity related to the warranty accrual was as follows:

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	29,	30,	29,	30,
	2007	2006	2007	2006
	(In thousands)			
Balance at beginning of period	\$ 2,421	\$ 1,757	\$ 2,462	\$ 2,031
Provision	1,413	1,317	4,804	3,693
Warranty usage(*)	(1,688)	(1,136)	(5,120)	(3,786)
Balance at end of period	\$ 2,146	\$ 1,938	\$ 2,146	\$ 1,938

(*) Warranty usage includes the pro rata expiration of product warranties unutilized.

9. 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 business offers products through a network of retail businesses throughout the United States and to certain countries through international distributors. The Company's home robots division includes mobile robots used in the maintenance of domestic households and sold primarily to retail outlets.

Government and Industrial

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

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

The table below presents segment information about revenue, cost of revenue, gross profit and income (loss) before income taxes:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)		(In thousands)	
Revenue:				
Home Robots	\$ 34,319	\$ 30,596	\$ 70,957	\$ 70,543
Government & Industrial	29,521	24,451	79,384	57,274
Total revenue	63,840	55,047	150,341	127,817
Cost of revenue:				
Home Robots	25,619	17,690	50,988	43,691
Government & Industrial	18,109	14,374	52,900	37,173
Total cost of revenue	43,728	32,064	103,888	80,864
Gross profit:				
Home Robots	8,700	12,906	19,969	26,852
Government & Industrial	11,412	10,077	26,484	20,101
Total gross profit	20,112	22,983	46,453	46,953
Research and development				
Other	4,739	4,345	13,074	10,946
Selling and marketing				
Other	11,115	4,712	30,108	19,197
General and administrative				
Other	6,459	4,663	17,538	14,074
Other income, net				
Other	845	978	2,663	2,847
Income (loss) before income taxes				
Other	\$ (1,356)	\$ 10,241	\$ (11,604)	\$ 5,583

Geographic Information

For the three months ended September 29, 2007 and September 30, 2006, sales to non-U.S. customers accounted for 14.2% and 10.8% of total revenue, respectively, and for the nine months ended September 29, 2007 and September 30, 2006, sales to non-U.S. customers accounted for 12.8% and 9.8% of total revenue, respectively.

Significant Customers

For the three months ended September 29, 2007 and September 30, 2006, U.S. federal government orders, contracts and subcontracts accounted for 37.8% and 36.9% of total revenue, respectively, and for the nine months ended September 29, 2007 and September 30, 2006, U.S. federal government orders, contracts and subcontracts accounted for 44.1% and 39.7% of total revenue, respectively.

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 December 30, 2006, which has been filed with the Securities and Exchange Commission (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 and 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, our home robot and government and industrial robots divisions, competition and strategy and our market position, market acceptance of our products, seasonal factors, revenue recognition, profits, growth of revenues, composition of revenues, cost of revenues, operating expenses, sales, marketing and support expenses, general and administrative expenses, research and development expenses, compensation costs, our ability to attract and retain qualified personnel, credit facility and equipment facility, valuations of investments, valuation and composition of stock-based awards, SFAS No. 123(R), 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 December 30, 2006, as well as elsewhere in this report. 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 caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made.

Overview

iRobot provides robots that enable people to complete complex tasks in a better way. Founded in 1990 by roboticists who performed research at the Massachusetts Institute of Technology, we have developed proprietary technology incorporating advanced concepts in navigation, mobility, manipulation and artificial intelligence to build industry-leading robots. Our Roomba floor vacuuming, Scooba floor washing, Looj gutter cleaning and Verro pool cleaning robots perform time-consuming domestic chores, and our PackBot tactical military robots perform battlefield reconnaissance and bomb disposal. In addition, we are developing the Small Unmanned Ground Vehicle reconnaissance robot for the U.S. Army's Future Combat Systems program and, in conjunction with Deere & Company, the R-Gator unmanned ground vehicle. We sell our robots to consumers through a variety of distribution channels, including chain stores and other national retailers, and our on-line store, and to the U.S. military and other government agencies worldwide.

As of September 29, 2007, we had 418 full-time employees. We have developed expertise in most 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, thereby reducing the time, cost and risk of product development. We believe that 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 home robot and military 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 home robot and military 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; valuation allowances (specifically sales returns and other 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 December 30, 2006.

In a review of our stock-based compensation accounting methodology performed during our fiscal quarter ended June 30, 2007, we determined that a cumulative adjustment of \$0.5 million of incremental stock-based compensation expense was required due to a correction in the application of SFAS No. 123(R). Upon adoption of SFAS No. 123(R) on January 1, 2006, we incorrectly valued 259,700 stock options that were granted between the date that we filed our initial Form S-1 registration statement with the Securities and Exchange Commission on July 27, 2005 and the date we became a public company (November 8, 2005). We believe, in accordance with APB 28, paragraph 29, that this adjustment will not be material to our estimated full year results for 2007. In addition, we do not believe the adjustment is material to the amounts reported by us in previous periods. This cumulative adjustment was recorded during the three month period ended June 30, 2007 and is included in the cost of revenue and operating expenses for the nine month period ended September 29, 2007.

Overview of Results of Operations

The following table sets forth our results of operations as a percentage of revenue for the three and nine month periods ended September 29, 2007 and September 30, 2006:

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	29,	30,	29,	30,
	2007	2006	2007	2006
Revenue				
Product revenue	91.9%	87.9%	89.2%	87.1%
Contract revenue	8.1	12.1	10.8	12.9
Total revenue	100.0	100.0	100.0	100.0
Cost of Revenue				
Cost of product revenue	61.4	51.5	59.8	54.5
Cost of contract revenue	7.1	6.7	9.3	8.8
Total cost of revenue	68.5	58.2	69.1	63.3
Gross profit	31.5	41.8	30.9	36.7
Operating Expenses				
Research and development	7.4	7.9	8.7	8.6
Selling and marketing	17.4	8.6	20.0	15.0
General and administrative	10.1	8.5	11.7	11.0

Edgar Filing: IROBOT CORP - Form 10-Q

Total operating expenses	34.9	25.0	40.4	34.6
Operating income (loss)	(3.4)	16.8	(9.5)	2.1
Other income, net	1.3	1.8	1.8	2.3
Income (loss) before income taxes	(2.1)	18.6	(7.7)	4.4
Income tax expense	0.1	0.4	0.1	0.2
Net Income (loss)	(2.2)%	18.2%	(7.8)%	4.2%

14

Table of Contents**Comparison of Three and Nine Months Ended September 29, 2007 and September 30, 2006****Revenue**

	Three Months Ended				Nine Months Ended			
	September 29, 2007	September 30, 2006	Dollar Change	Percent Change	September 29, 2007	September 30, 2006	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			

Total revenue	\$63,840	\$55,047	\$8,793	16.0%	\$150,341	\$127,817	\$22,524	17.6%
---------------	----------	----------	---------	-------	-----------	-----------	----------	-------

Total revenue for the three months ended September 29, 2007 increased to \$63.8 million, or 16.0%, compared to \$55.0 million for the three months ended September 30, 2006. Revenue increased approximately \$3.7 million, or 12.2%, in our home robots business and increased approximately \$5.1 million, or 20.7%, in our government and industrial business.

The \$3.7 million increase in revenue from our home robots division for the three months ended September 29, 2007 was driven by a \$2.4 million increase in home floor care robots revenue due to a 3.1% increase in units shipped and a 4.9% increase in average selling prices, and a \$1.3 million increase in product life cycle revenue (spares and accessories), as compared to the three months ended September 30, 2006. Total home floor care robots shipped in the three months ended September 29, 2007 was approximately 229,000 units compared to approximately 222,000 units in the three months ended September 30, 2006. The \$5.1 million increase in revenue from our government and industrial business for the three months ended September 29, 2007 as compared to three months ended September 30, 2006 was due to a \$4.5 million increase in product life cycle revenue (robot spares, services and training) of our military robots combined with a \$2.2 million increase in product sales driven by a 4.6% increase in units shipped, 114 units compared to 109 units, and a 12.0% increase in associated net average selling prices. These increases were partially offset by a decrease of \$1.5 million in recurring contract development revenue generated under funded research and development contracts due mainly to a one-time benefit of \$2.2 million recorded in the three months ended September 30, 2006 relating to a contract modification with the United Kingdom Ministry of Defence.

Total revenue for the nine months ended September 29, 2007 increased by \$22.5 million to \$150.3 million, or 17.6%, compared to \$127.8 million for the nine months ended September 30, 2006. Revenue increased approximately \$0.4 million, or 0.6%, in our home robots business and increased approximately \$22.1 million, or 38.6%, in our government and industrial business.

The \$0.4 million increase in revenue from our home robots division was driven by a \$2.6 million increase in product life cycle revenue (spares and accessories) offset by a \$2.2 million decrease driven by a 0.4% decrease in units shipped and a 2.8% decrease in average selling prices as compared to the nine months ended September 30, 2006. Total home floor care robots shipped in the nine months ended September 29, 2007 was approximately 456,000 units compared to approximately 458,000 units in the nine months ended September 30, 2006. The \$22.1 million increase in revenue from our government and industrial business for the nine months ended September 29, 2007 as compared to nine months ended September 30, 2006 was due to a 37.0% increase in unit shipments of our military robots combined with a 17.3% increase in associated net average selling prices and a 38.5% increase in product life cycle revenue (robot spares, services and training) of our military robots. Total military robot units shipped in the nine months ended September 29, 2007 was 363 compared to 265 in the nine months ended September 30, 2006.

Cost of Revenue

	Three Months Ended				Nine Months Ended			
	September 29, 2007	September 30, 2006	Dollar Change	Percent Change	September 29, 2007	September 30, 2006	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total cost of revenue	\$43,728	\$32,064	\$11,664	36.4%	\$103,888	\$80,864	\$23,024	28.5%

As a percentage
of total revenue

68.5%

58.2%

15

69.1%

63.3%

Table of Contents

Total cost of revenue increased to \$43.7 million in the three months ended September 29, 2007, compared to \$32.1 million in the three months ended September 30, 2006. The increase is primarily due to higher costs associated with the 3.1% increase in home robot unit sales and 4.6% increase in government and industrial unit sales and higher average unit costs driven by expansion of our product line into higher end models in our home robots division.

The home robots division cost of revenue increased as a percent of revenue by 16.8 percentage points in the three months ended September 29, 2007 as compared to the three months ended September 30, 2006. This increase was primarily attributable to a 34.3% increase in average unit costs, including the impact of increased nickel prices, the most significant cost element of our batteries, partially offset by a net 4.9% increase in average selling prices. The average selling price increase was a result of the sale of higher priced models offset by reserves taken for product transition costs.

The government and industrial robots division cost of revenue increased as a percent of revenue by 2.6 percentage points in the three months ended September 29, 2007 as compared to the three months ended September 30, 2006. This was due to a one time reduction of costs of contract revenue in the comparable three month period ended September 30, 2006, directly related to the United Kingdom Ministry of Defence contract modification, partially offset by a 3.3% decrease in the average unit costs and lower warranty costs.

Total cost of revenue increased to \$103.9 million in the nine months ended September 29, 2007, compared to \$80.9 million in the nine months ended September 30, 2006. The increase is primarily due to higher costs associated with the 37.0% increase in government and industrial unit sales, and a 9.7% and 4.6% increase in the average unit costs of our home robots and government and industrial robots, respectively.

The home robots division cost of revenue increased as a percent of revenue by 9.9 percentage points in the nine months ended September 29, 2007 as compared to the nine months ended September 30, 2006. This increase was primarily attributable to higher warranty and overhead costs, as well as higher average unit costs driven by increased battery costs due to the increased cost of nickel and the mix of higher cost products.

The government and industrial robots division cost of revenue increased as a percent of revenue by 1.7 percentage points in the nine months ended September 29, 2007 as compared to the nine months ended September 30, 2006. This increase was due to a one time reduction of costs of contract revenue in the comparable nine month period ended September 30, 2006 and higher overhead costs associated with an expanded infrastructure to support our growth and achieve operational scale as well as higher warranty costs, offset by lower standard costs and contract costs as a percentage of revenue.

Gross Profit

	Three Months Ended				Nine Months Ended			
	September 29, 2007	September 30, 2006	Dollar Change	Percent Change	September 29, 2007	September 30, 2006	Dollar Change	Percent Change
	(Dollar in thousands)				(Dollars in thousands)			
Total gross profit	\$20,112	\$22,983	\$(2,871)	(12.5%)	\$46,453	\$46,953	\$(500)	(1.1%)
As a percentage of total revenue	31.5%	41.8%			30.9%	36.7%		

Gross profit decreased 12.5% to \$20.1 million in the three months ended September 29, 2007, from \$23.0 million in the three months ended September 30, 2006. Gross profit as a percentage of revenue decreased to 31.5% in the three months ended September 29, 2007 from 41.8% of revenue in the three months ended September 30, 2006. This decrease in gross profit as a percentage of total revenue was the result of the home robots division gross profit decreasing 16.8 percentage points and the government and industrial division decreasing 2.6 percentage points, each compared to the three months ended September 30, 2006. Exclusive of a one time settlement of the United Kingdom Ministry of Defence contract modification, which occurred during the three months ended September 30, 2006, government and industrial division gross profit would have increased 4.6 percentage points.

Gross profit decreased 1.1% to \$46.5 million in the nine months ended September 29, 2007, from \$47.0 million in the nine months ended September 30, 2006. Gross profit as a percentage of revenue decreased to 30.9% in the nine

months ended September 29, 2007 from 36.7% of revenue in the nine months ended September 30, 2006. This decrease in gross profit as a percentage of total revenue was the result of the home robots division gross profit

Table of Contents

decreasing 9.9 percentage points and by the government and industrial division decreasing 1.7 percentage points, each compared to the nine months ended September 30, 2006.

Research and Development

	Three Months Ended				Nine Months Ended			
	September 29, 2007	September 30, 2006	Dollar Change	Percent Change	September 29, 2007	September 30, 2006	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total research and development expense	\$4,739	\$4,345	\$394	9.1%	\$13,074	\$10,946	\$2,128	19.4%
As a percentage of total revenue	7.4%	7.9%			8.7%	8.6%		

Research and development expenses increased by \$0.4 million, or 9.1%, to \$4.7 million (7.4% of revenue) in the three months ended September 29, 2007, from \$4.3 million (7.9% of revenue) for the three months ended September 30, 2006. The increase in research and development expenses is primarily due to an increase of \$0.7 million in compensation, benefits expense and travel attributed to increased headcount. Material costs associated with internal research and development projects decreased \$0.4 million.

Research and development expenses increased by \$2.1 million, or 19.4%, to \$13.1 million (8.7% of revenue) in the nine months ended September 29, 2007, from \$11.0 million (8.6% of revenue) for the nine months ended September 30, 2006. The increase in research and development expenses is primarily due to an increase of \$1.5 million in compensation, benefits expense and travel attributed to increased headcount. Consulting and material costs associated with internal research and development projects increased by \$0.2 million each.

Given the seasonality of our business and the impact on quarterly revenues, research and development expenses are expected to fluctuate as a percent of revenue throughout the year. For the full fiscal year 2007, we expect research and development expenses to be approximately 7% of revenue.

Overall research and development headcount increased to 105 at September 29, 2007 compared to 92 as of September 30, 2006, an increase of 13 employees or 14%.

In addition to our internal research and development activities discussed above, we incur research and development expenses under funded development arrangements with both governments and industrial third parties. For the three and nine months ended September 29, 2007, these expenses amounted to \$4.5 million and \$14.0 million compared to \$3.7 million and \$11.2 million for the three and nine months ended September 30, 2006, respectively. In accordance with generally accepted accounting principles, these expenses have been classified as cost of revenue rather than research and development expense.

Selling and Marketing

	Three Months Ended				Nine Months Ended			
	September 29, 2007	September 30, 2006	Dollar Change	Percent Change	September 29, 2007	September 30, 2006	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total selling and marketing expense	\$11,115	\$4,712	\$6,403	135.9%	\$30,108	\$19,197	\$10,911	56.8%
As a percentage of total revenue	17.4%	8.6%			20.0%	15.0%		

Selling and marketing expenses increased by \$6.4 million, or 135.9%, to \$11.1 million (17.4% of revenue) in the three months ended September 29, 2007 from \$4.7 million (8.6% of revenue) in the three months ended September 30, 2006. The increase was primarily driven by increases of \$4.1 million in direct marketing, online and

television media, and direct fulfillment related expenses due primarily to 174% growth in our direct business, including a recently introduced Scooba infomercial program. Our direct business, which carries a higher selling and marketing cost per revenue dollar than retail sales, accounted for 22.5% of our home robots division revenue in the three months ended September 29, 2007 compared to 9.2% in the three months ended September 30, 2006. Trade shows and other marketing related activities increased by \$1.4 million and

Table of Contents

compensation and travel expenses increased by \$0.7 million as compared to the three months ended September 30, 2006.

Selling and marketing expenses increased by \$10.9 million, or 56.8%, to \$30.1 million (20.0% of revenue) in the nine months ended September 29, 2007 from \$19.2 million (15.0% of revenue) in the nine months ended September 30, 2006. The increase in selling and marketing expense was primarily driven by increases of \$7.7 million in direct marketing, online and television media, and direct fulfillment related expenses due to 129% growth in our direct business including a recently introduced Scooba infomercial program. Our direct business accounted for 28.8% of our home robots division revenue in the nine months ended September 29, 2007 compared to 12.7% in the nine months ended September 30, 2006. Trade shows and other marketing related activities increased by \$0.9 million and compensation, travel and other people related costs increased by \$2.4 million as compared to the nine months ended September 30, 2006.

For the full fiscal year 2007, we expect selling and marketing expenses to be approximately 19% of revenue with sales and marketing spending generally increasing as the holiday season approaches.

Overall selling and marketing headcount increased to 36 at September 29, 2007 compared to 28 as of September 30, 2006, an increase of 8 employees or 29% growth.

General and Administrative

	Three Months Ended				Nine Months Ended			
	September 29, 2007	September 30, 2006	Dollar Change	Percent Change	September 29, 2007	September 30, 2006	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total general and administrative expense	\$6,459	\$4,663	\$1,796	38.5%	\$17,538	\$14,074	\$3,464	24.6%
As a percentage of total revenue	10.1%	8.5%			11.7%	11.0%		

General and administrative expenses increased by \$1.8 million, or 38.5%, to \$6.5 million (10.1% of revenue) in the three months ended September 29, 2007 from \$4.7 million (8.5% of revenue) in the three months ended September 30, 2006. The increase in general and administrative expenses was driven by increased compensation expense due to increased headcount and increased legal fees, mainly relating to proprietary technology litigation, over the comparable period.

General and administrative expenses increased by \$3.5 million, or 24.6% to \$17.5 million (11.7% of revenue) in the nine months ended September 29, 2007 from \$14.1 million (11.0% of revenue) in the nine months ended September 30, 2006. The increase in general and administrative expenses was driven by increased compensation expense due to increased headcount, increased stock compensation expense, and increased legal fees, mainly relating to proprietary technology litigation, over the comparable period.

Given the seasonality of our business and the impact on quarterly revenues, general and administrative expenses are expected to fluctuate as a percent of revenue throughout the year. For the full fiscal year 2007, we expect general and administrative expenses to be approximately 9% of revenue as compared to the 10.1% of revenue we experienced in the three months ended September 29, 2007.

Overall general and administrative headcount increased to 84 at September 29, 2007 compared to 69 as of September 30, 2006, an increase of 15 employees or 22% growth.

Table of Contents*Other Income, Net*

	Three Months Ended				Nine Months Ended			
	September	September	Dollar Change	Percent Change	September	September	Dollar Change	Percent Change
	29, 2007	30, 2006			29, 2007	30, 2006		
	(Dollars in thousands)				(Dollars in thousands)			
Total other income net	\$845	\$ 978	\$(133)	(13.6%)	\$,663	\$ 2,847	\$(184)	(6.5%)
As a percentage of total revenue	1.3%	1.8%			1.8%	2.3%		

Other income, net amounted to \$0.8 million for the three months ended September 29, 2007 compared to \$1.0 million for the three months ended September 30, 2006.

Other income, net amounted to \$2.7 million for the nine months ended September 29, 2007 compared to \$2.8 million for the nine months ended September 30, 2006.

Other income, net was directly related to interest income resulting from the investment in auction rate debt securities and money market accounts. The lower other income, net for both the three and nine month periods ended September 29, 2007 as compared to the three and nine month periods ended September 30, 2006 is attributable to lower average auction rate debt securities and money market account balances.

Income Tax Provision

	Three Months Ended				Nine Months Ended			
	September	September	Dollar Change	Percent Change	September	September	Dollar Change	Percent Change
	29, 2007	30, 2006			29, 2007	30, 2006		
	(Dollars in thousands)				(Dollars in thousands)			
Total income tax provision	\$ 22	\$ 199	\$(177)	(88.9%)	\$ 51	\$ 235	\$(184)	(78.3%)
As a percentage of total revenue	0.1%	0.4%			0.1%	0.2%		

The provision for income taxes for the three and nine months ended September 29, 2007 and September 30, 2006 consists primarily of state taxes.

Liquidity and Capital Resources

At September 29, 2007 our principal sources of liquidity were cash and cash equivalents totaling \$23.2 million, short-term investments of \$26.3 million, and accounts receivable of \$35.2 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. However, cash flow will be impacted in the coming quarters as we build out new leased facilities for occupancy during the second quarter of 2008. Accordingly, our capital spending is generally limited to leasehold improvements, computers, office furniture and product-specific production tooling and test equipment. In the nine month periods ended September 29, 2007 and September 30, 2006, we spent \$6.5 million and \$3.8 million, respectively, on capital equipment.

Our home robots product sales are, and are expected to continue to be, highly seasonal. This seasonality typically results in a break even or net use of cash in support of operating needs during the first half of the year with the low point generally occurring in the third quarter or early in the fourth quarter, and a favorable cash flow towards the end of the year.

Table of Contents***Discussion of Cash Flows***

Net cash used by our operating activities in the nine months ended September 29, 2007 was \$14.2 million compared to net cash used by operating activities of \$0.8 million in the nine months ended September 30, 2006. The cash used by our operating activities in the nine months ended September 29, 2007 was primarily due to an increase in accounts receivable (including unbilled revenue) of \$7.4 million, an increase in inventory of \$22.8 million in anticipation of the holiday buying season, and a net loss of \$11.7 million, offset by a decrease in other assets of \$0.8 million and a net increase in liabilities of \$19.4 million. In addition, in the nine months ended September 29, 2007, we had depreciation and amortization of approximately \$4.0 million and stock-based compensation of \$3.5 million, both of which are non-cash expenses. The cash used by our operating activities in the nine months ended September 30, 2006 was primarily due to an increase in accounts receivable (including unbilled revenue) of \$7.3 million and an increase in inventory of \$7.9 million in anticipation of the holiday buying season, offset by net income of \$5.3 million, a decrease in other assets of \$0.4 million, and an increase in liabilities of \$4.1 million. In addition, in the nine months ended September 30, 2006, we had depreciation and amortization of approximately \$2.7 million and stock-based compensation of \$1.8 million, both of which are non-cash expenses.

Net cash provided by our investing activities was \$32.0 million in the nine months ended September 29, 2007 compared to net cash used by our investing activities of \$67.7 million in the nine months ended September 30, 2006. Investing activities in the nine months ended September 29, 2007 represent the sale of short-term investments of \$83.3 million, offset by the purchase of short-term investments of \$44.8 million and the purchase of capital equipment of \$6.5 million. Investing activities in the nine months ended September 30, 2006 represent the purchase of short-term investments of \$108.2 million and capital equipment of \$3.8 million, offset by the sale of short-term investments of \$44.3 million.

Net cash used by our financing activities was approximately \$0.3 million in the nine months ended September 29, 2007 compared to net cash provided by our financing activities of \$0.8 million in the nine months ended September 30, 2006. Included in the financing activities for the nine months ended September 29, 2007 was a \$1.6 million payment by us of the minimum tax withholding obligation relating to a stock option exercise during the period. This figure was offset by \$1.3 million of proceeds from the exercise of stock options. Net cash provided by our financing activities for the nine months ended September 30, 2006 represent the proceeds from the exercise of common stock options.

The majority of our long-lived assets for the nine months ended September 29, 2007 and September 30, 2006 are located in the United States. However, we have invested in production tooling for the manufacture of the Roomba, Scooba and Looj product lines in China.

Working Capital Facility

On June 5, 2007, we entered into a \$35 million unsecured revolving credit facility with Bank of America, N.A. to replace our expired working capital line of credit with Bank of America. The credit facility will be available to fund working capital and other corporate purposes. The interest on loans under our working capital line of credit will accrue, at our election, at either (i) Bank of America's prime rate minus 1% or (ii) the Eurodollar rate plus 1.25%. The credit facility will terminate and all amounts outstanding thereunder will be due and payable in full on June 5, 2010. As of September 29, 2007, we had letters of credit outstanding of \$2.1 million and \$32.9 million available 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, we are required to meet certain financial covenants customary with this type of agreement, including maintaining a minimum specified tangible net worth, a minimum specified ratio of current assets to current liabilities and a minimum specified annual net income.

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

Table of Contents

period or is not waived, our obligations under the credit facility may be accelerated. At September 29, 2007, we were in compliance with all covenants under the credit facility.

Equipment Financing Facility

On June 5, 2007, we entered into a \$15 million secured equipment facility with Banc of America Leasing and Capital, LLC under which we can finance the acquisition of equipment, furniture and leasehold improvements. We may borrow amounts under the equipment facility until July 1, 2008 and any amounts borrowed during that period will accrue interest at 30-day LIBOR plus 1%. After July 1, 2008, all amounts then outstanding under the equipment line will be repaid in 60 equal monthly installments commencing in July 2008 and will accrue interest, at our election, at either a fixed or variable rate of interest. Our obligations under the equipment facility will be secured by any financed equipment. As of September 29, 2007, we had no amounts outstanding and \$15.0 million available under our equipment financing line of credit.

This equipment facility contains customary terms and conditions for equipment facilities of this type, including, without limitation, restrictions on our ability to transfer, encumber or dispose of the financed equipment. In addition, we are required to meet certain financial covenants customary to this type of agreement, including maintaining a minimum specified tangible net worth, a minimum specified ratio of current assets to current liabilities and a minimum specified annual net income.

This equipment 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, or if we repay all of our indebtedness under our credit facility with Bank of America, N.A., our obligations under this equipment facility may be accelerated. At September 29, 2007, we were in compliance with all covenants under the equipment facility.

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 capital line of credit. We do anticipate making significant capital commitments in the next several months for expenditures associated with the planned move to our new corporate headquarters on or about May 1, 2008. These expenditures will be jointly funded by the landlord for this site and by us. Other than this project, 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 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. Although we are currently not a party to any agreement or binding letter of intent with respect to potential investments in, or acquisitions of, businesses, services or technologies, we may enter into these types of arrangements in the future, 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.

Table of Contents**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. The following table describes our commitments to settle contractual obligations in cash as of September 29, 2007:

	Less Than 1 Year	Payments Due by Period			Total
		1 to 3 Years	3 to 5 Years	More Than 5 Years	
			(In thousands)		
Operating leases	\$ 2,813	\$ 4,806	\$ 4,460	\$ 15,595	\$ 27,674
Minimum contractual payments		8,500	10,500	1,500	20,500
Total	\$ 2,813	\$ 13,306	\$ 14,960	\$ 17,095	\$ 48,174

Off-Balance Sheet Arrangements

As of September 29, 2007, 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 September 29, 2007, we had unrestricted cash and cash equivalents of \$23.2 million and short-term investments of \$26.3 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 principal amount of the investment to fluctuate. To minimize this risk in the future, we intend to maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including auction rate 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 September 29, 2007, all of our cash equivalents were held in money market accounts and our short-term investments were comprised of auction rate securities.

Our exposure to market risk also relates to the increase or decrease in the amount of interest expense we would be required to pay on outstanding debt instruments, primarily certain borrowings under our bank line of credit. The advances under this line of credit bear a variable rate of interest determined as a function of the prime rate or the published LIBOR rate at the time of the borrowing. At September 29, 2007, there were no borrowings outstanding under our working capital line of credit or our equipment line.

Exchange Rate Sensitivity

Nearly all of our revenue is derived from transactions denominated in U.S. dollars, even though 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. We expect the level of non-US dollar denominated revenue to increase as we continue to expand internationally. We will regularly monitor this activity to determine if actions should be undertaken in order to minimize any related exposure.

Table of Contents**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 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 in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. 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.

On August 17, 2007, we filed a lawsuit in Massachusetts Superior Court against Robotic FX, Inc. and Jameel Ahed alleging, among other things, misappropriation of trade secrets and breach of contract. The case was subsequently removed to the United States District Court for the District of Massachusetts. On August 17, 2007, we filed a lawsuit in the United States District Court for the Northern District of Alabama against Robotic FX, Inc. alleging willful infringement of two patents owned by us. In each matter, we seek both injunctive and monetary relief.

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 December 30, 2006, which could materially affect our business, financial condition or future results. There are no material changes to the Risk Factors described in our Annual Report on Form 10-K for the fiscal year ended December 30, 2006 other than changes to the risk factors listed below entitled *We depend on single source manufacturers, and our reputation and results of operations would be harmed if these manufacturers fail to meet our requirements.* and *We depend on the experience and expertise of our senior management team and key technical employees, and the loss of any key employee may impair our ability to operate effectively.* These risk factors have been updated to reflect an update regarding our contract manufacturers and recent changes in management, respectively. 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.

We depend on single source manufacturers, and our reputation and results of operations would be harmed if these manufacturers fail to meet our requirements.

We currently depend on one contract manufacturer, Jetta Company Limited, to manufacture our Roomba 400 series and Scooba series of home robot products at a single plant in China, and one contract manufacturer, Kin Yat Industrial Co. Ltd., to manufacture our Roomba 500 series of home robot products at a single plant in China. Moreover, we rely on one contract manufacturer, Gem City Engineering Corporation, to manufacture our military products at a single plant in the United States. We do not have a long-term contract with Jetta Company Limited and

Table of Contents

the manufacture of our consumer products is provided on a purchase-order basis. These manufacturers supply substantially all of the raw materials and provide all facilities and labor required to manufacture our products. If these companies were to terminate their arrangements with us or fail to provide the required capacity and quality on a timely basis, we would be unable to manufacture our products until replacement contract manufacturing services could be obtained. To qualify a new contract manufacturer, familiarize it with our products, quality standards and other requirements, and commence volume production is a costly and time-consuming process. We cannot assure you that we would be able to establish alternative manufacturing relationships on acceptable terms.

Our reliance on these contract manufacturers involves certain risks, including the following:

lack of direct control over production capacity and delivery schedules;

lack of direct control over quality assurance, manufacturing yields and production costs;

lack of enforceable contractual provisions over the production and costs of consumer products;

risk of loss of inventory while in transit from China; and

risks associated with international commerce with China, including unexpected changes in legal and regulatory requirements, changes in tariffs and trade policies, risks associated with the protection of intellectual property and political and economic instability.

Any interruption in the manufacture of our products would be likely to result in delays in shipment, lost sales and revenue and damage to our reputation in the market, all of which would harm our business and results of operations. In addition, while our obligations with our contract manufacturers in China are typically denominated in U.S. dollars, changes in currency exchange rates could impact our suppliers and increase our prices. In particular, the Chinese government announced in 2005 that the Chinese yuan has moved to a managed floating exchange rate regime, which could lead to our suppliers in China negotiating increased pricing terms with us.

We depend on the experience and expertise of our senior management team and key technical employees, and the loss of any key employee may impair our ability to operate effectively.

Our success depends upon the continued services of our senior management team and key technical employees, such as our project management personnel and senior engineers. Moreover, we often must comply with provisions in government contracts that require employment of persons with specified levels of education and work experience. Each of our executive officers, key technical personnel and other employees could terminate his or her relationship with us at any time. The loss of any member of our senior management team might significantly delay or prevent the achievement of our business objectives and could materially harm our business and customer relationships. In addition, because of the highly technical nature of our robots, the loss of any significant number of our existing engineering and project management personnel could have a material adverse effect on our business and operating results.

Item 5. Other Information

Our policy governing transactions in our securities by 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 officers (including Joseph Dyer, President, Government and Industrial Robots; Geoffrey Clear, Senior Vice President, Chief Financial Officer & Treasurer and Glen Weinstein, Senior Vice President, General Counsel & Secretary) of the Company have entered into a trading plan (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

Table of Contents

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. However, we undertake no obligation to update or revise the information provided herein, including for revision or termination of an established trading plan, other than in such quarterly and annual reports.

Table of Contents

Item 6. Exhibits

<i>Exhibit Number</i>	Description
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

Table of Contents

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: October 31, 2007

By: /s/ Geoffrey P. Clear
Geoffrey P. Clear
Senior Vice President, Chief Financial
Officer and Treasurer (Duly Authorized
Officer and Principal Financial Officer)

27

Table of Contents

EXHIBIT INDEX

<i>Exhibit Number</i>	Description
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