

iRobot Corporation.
IRBT - \$89.10 – NasdaqGS

Recommendation: Sell Short

Reasons For Short Sale Recommendation

- **High multiple, 30P/E, growth company.**
- **Growth slowing drastically.**
- **4Q18 EPS cut from \$0.94 to \$0.50.**
- **High margin commodity product.**
- **Lots of competitors with similar products.**
- **Chinese tariff of 10% will take a bite out of margins, because they can't raise prices.**
- **Company increasing guidance for 2018, analysts cutting 2019 numbers.**

Financials

Market Capitalization	\$2.39B	Revenue/Shr (TTM)	\$35.09
Enterprise Value	\$2.39B	EBITDA (TTM)	\$118.57M
Trailing P/E	43.65	Diluted Earnings/Shr mrq)	\$2.00
Forward P/E	31	Total Cash (MRQ)	\$127.33M
PEG ratio (5 Yr Expected)	1.59	Total Cash/Shr (mrq)	\$4.65
Price/Sales (TTM)	2.45	Total Debt (MRQ)	N/A
Price/ Book (MRQ)	5.22	Current Ratio (MRQ)	2.89
Enterprise Value/Revenue	2.45	Book Value/Share (MRQ)	\$16.72
Enterprise Value/ EBITDA	20.15%	Operating cash Flow (TTM)	69.84M
Profit Margin %	5.90%	Levered Free Cash Flow(TTM)	12.73
Operating Margin (TTM)	8.79%	52 Week Change	20.17%
Return on Assets (TTM)	9.39%	Shares Short	7.75M
Return on Equity (TTM)	13.03%	% of shares Short	28.02%
Revenue (TTM)	\$976M	Short Ratio	9.7

(TTM) = Trailing 12 months, (MRQ) = Most recent quarter, M = Millions, B = Billions, m = Thousands

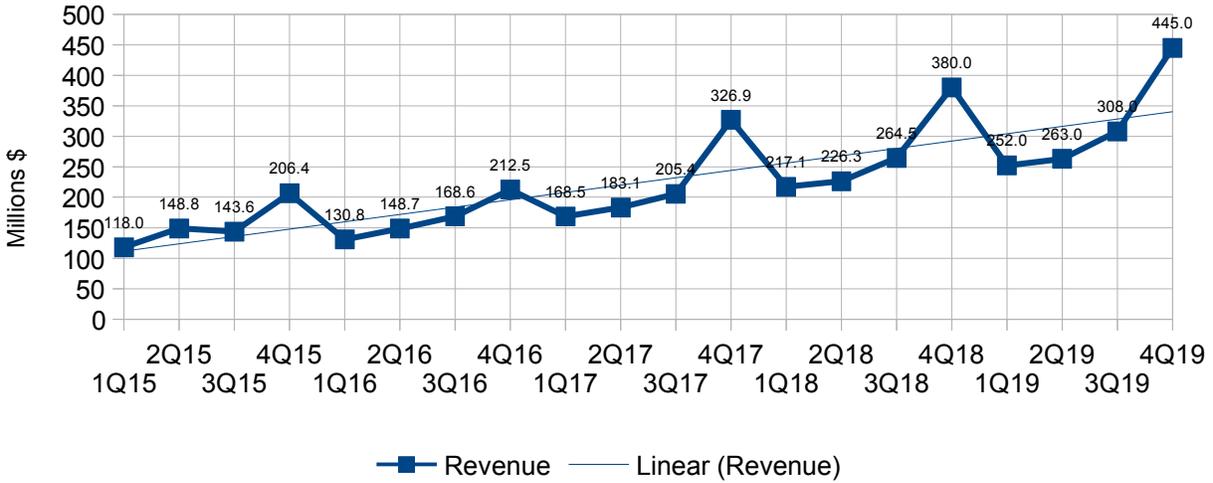
Short Thesis

IRobot makes the robotic Roomba vacuum cleaner. It is a good product, made in China with about 48-50% margins. The 2018 third quarter was far above analysts estimates. EPS was \$1.12 versus \$0.48 estimate. However, this stock meets several of our criteria as a short candidate. First, the product is a consumer commodity. Second, there are many competitors, this makes increasing prices more difficult, and third, they have high margins. **The 10% tariffs on Chinese products coming into the U.S. are going to be absorbed by the company and NOT passed on to the consumer.** This is a clear sign that they CAN'T pass on increased expenses because of the competition. We quickly found five competitors on Amazon. There are more. These products all look exactly alike.

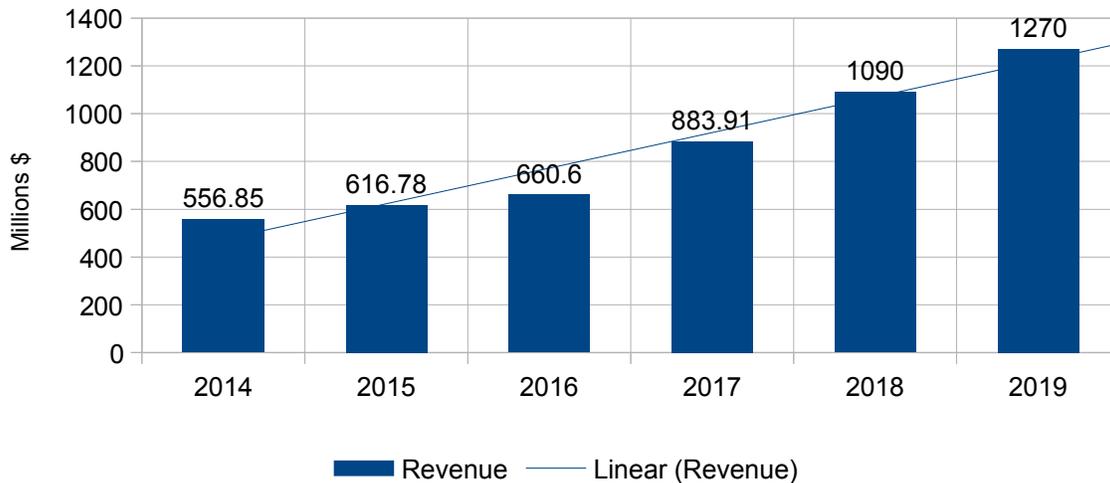
- 1). Ilife: [Ilife](#)
- 2). eufy: [eufy](#)
- 3). ecovacs Robotics: [Anker Innovations](#)
- 4). Pure Clean: [Pyle](#)
- 5). Shark: [Sharkclean](#)

Consumer products with high margins attract competitors. Margins come down due to price competition, just as sales growth slows. It is difficult to raise prices. We have seen this movie many times before, Sunbeam, Salton (the George Foreman grill. Wall street is always completely blindsided by the eventual collapse. Past revenue and earnings growth have been good which cause investors to over pay for slowing growth going forward. A P/E of 30 is ok when revenue increased 53% in 4Q17 and 33% for all of 2017. But for 2019, revenue is expected to grow only about 15% at best. This is less than half the rate of growth of 2017. Should an investor still pay 30 times for slowing growth? Net income increased 51% in 2018, that is worth 30 times, but **net income is only expected to increase 6.5% in 2019.** That is an 87% decrease in the rate of growth. We feel that the P/E should shrink, at least to some degree from 30. A P/E of 25 on 2019's EPS of \$2.85 = \$71/shr. A P/E of 20 = \$57/shr. This would be a decline of between 19%-35%. This is where we believe the stock will ultimately get to. Also, these estimates will probably be further cut going forward. Analysts are projecting a big fourth quarter in 2019 after three declining quarters. Um, ok.

IRBT Revenue 2015 to 2019 Est.



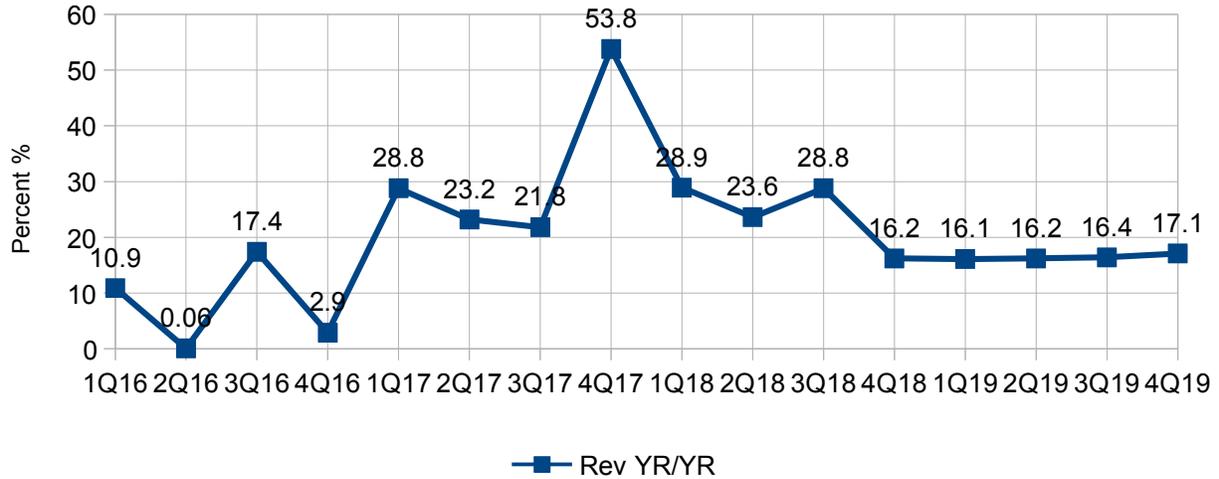
IRBT Revenue 2014 To 2019 Est.



Estimates for 2019 are too high.

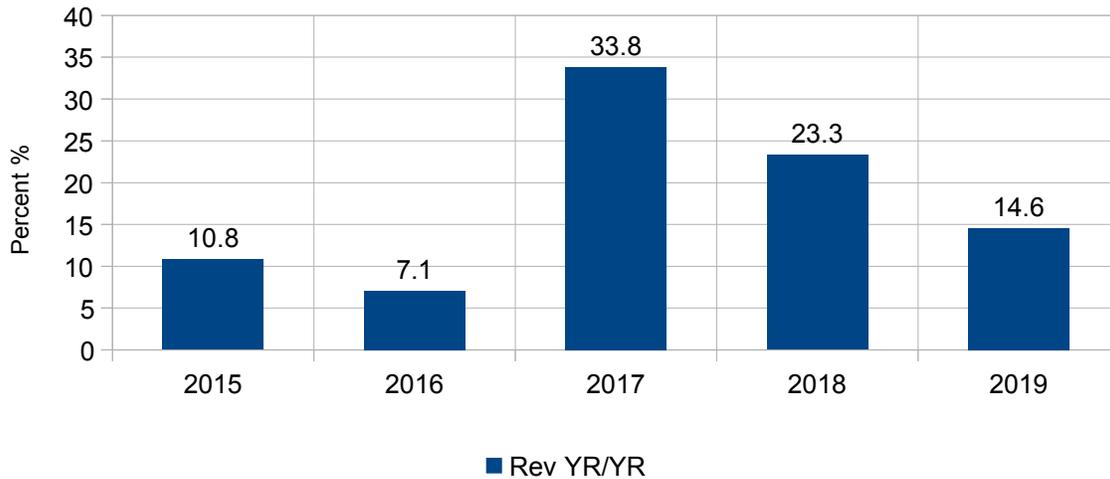
IRBT YR/YR Revenue Growth

2016 to 2019 Est.



IRBT YR/YR Revenue Growth %

2015 to 2019 Est.



2019 estimated revenue growth is more than 50% below 2017. And we believe these estimates will be cut next year.

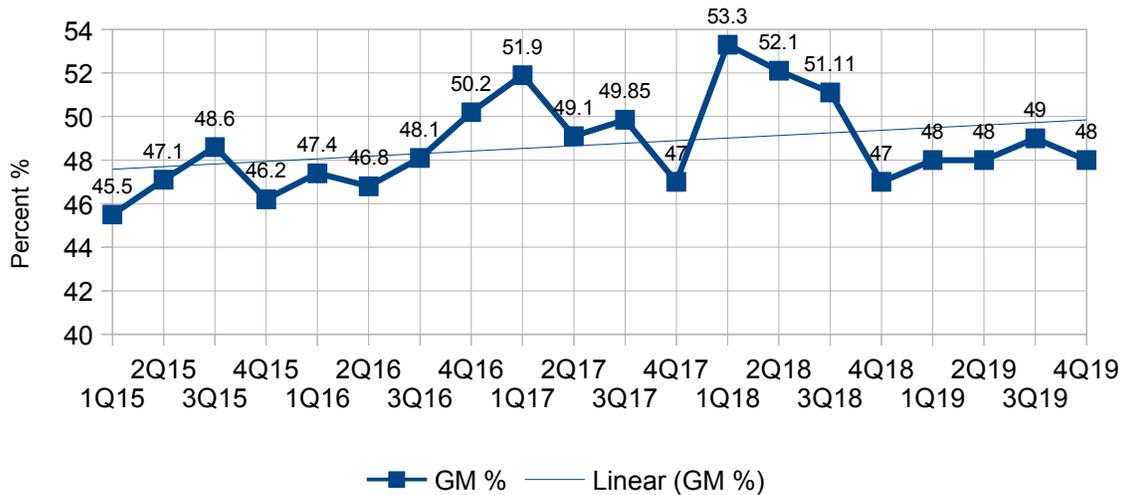
IRBT Gross Profit

2015 to 2018



IRBT Gross Margin %

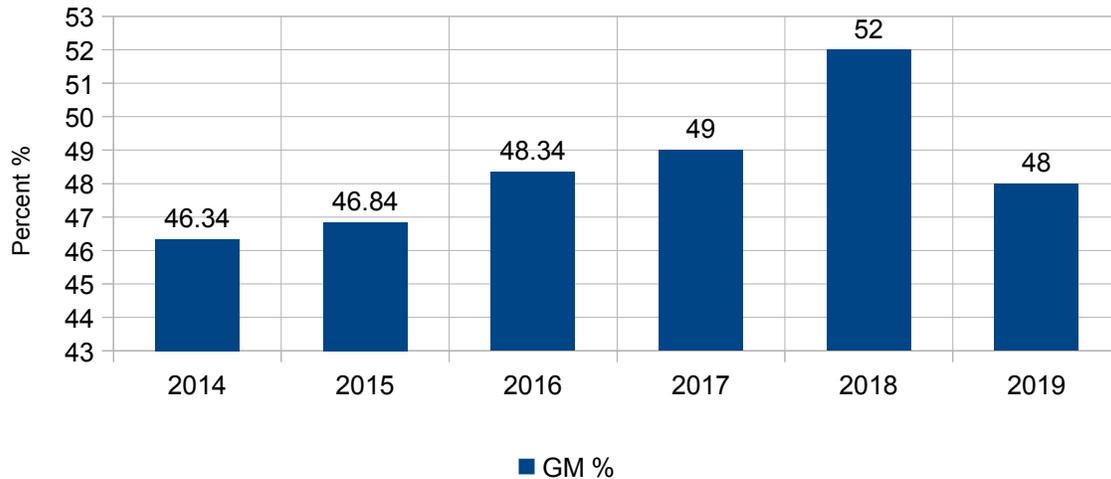
2015 to 2019 Est.



So, margins will be coming down but 2019 will be magically better than 2018? Slowing revenue growth plus lower gross margins is not a great situation.

IRBT Gross Margin %

2014 to 2019 Est.

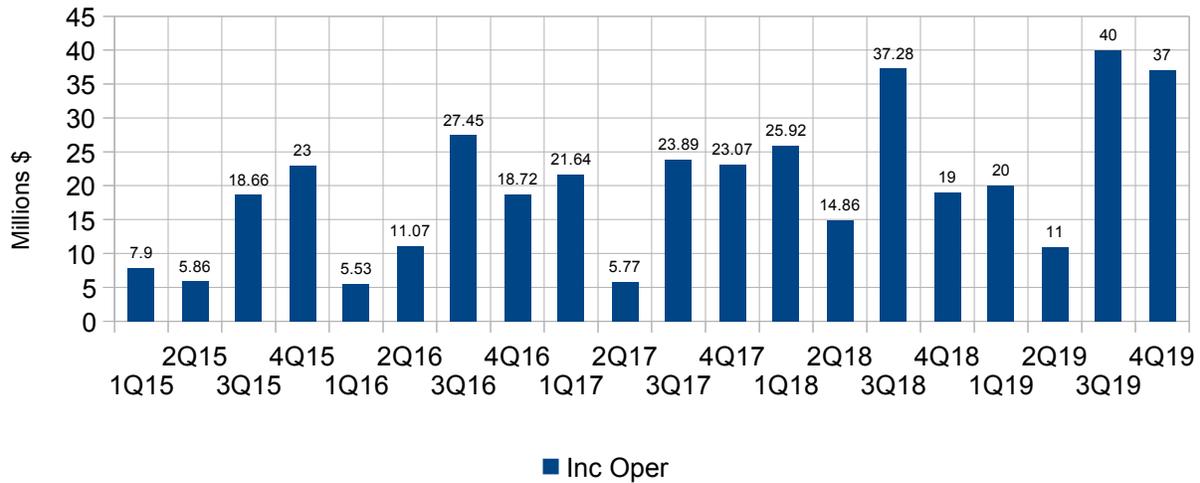


Once gross margins start to decline in a consumer product, they tend to keep declining. These robotic vacuum cleaners are all kind of the rage right now, hence the competition. Turns out, I own a Roomba. We bought it two years ago. It worked pretty good. We haven't used it in a long time. Its collecting dust right now in our basement, along with our bread maker, George Foreman Grill, Chinese Wok, Panini maker, etc...

The problem with these robotic vacuums is that you have to keep them plugged in at all times to keep them charged, so they are always out in view and in the way. Do you you want to look at your vacuum cleaner all day every day? I guess we don't.

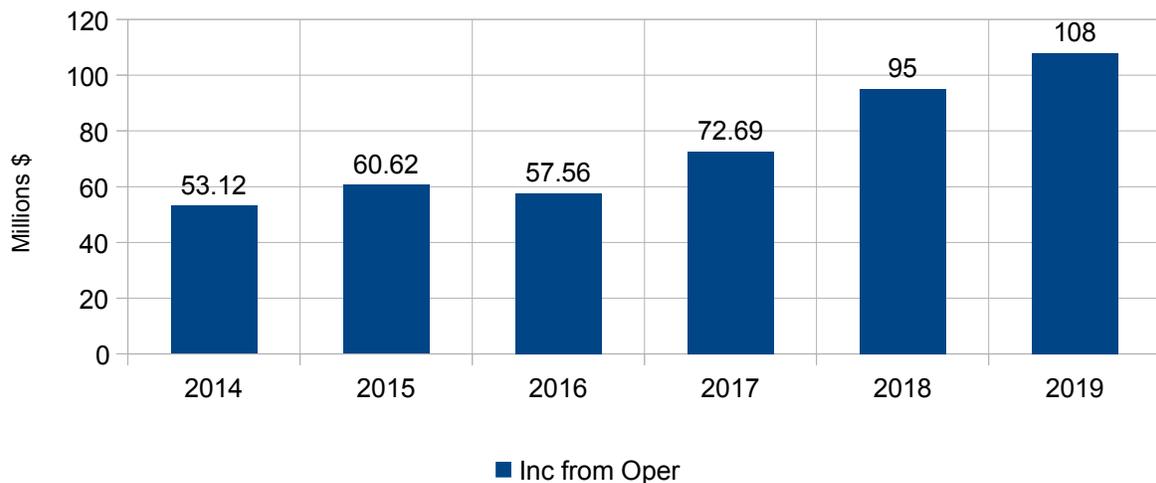
IRBT Income From Operations

2015 To 2019 Est.



IRBT Income From Operations

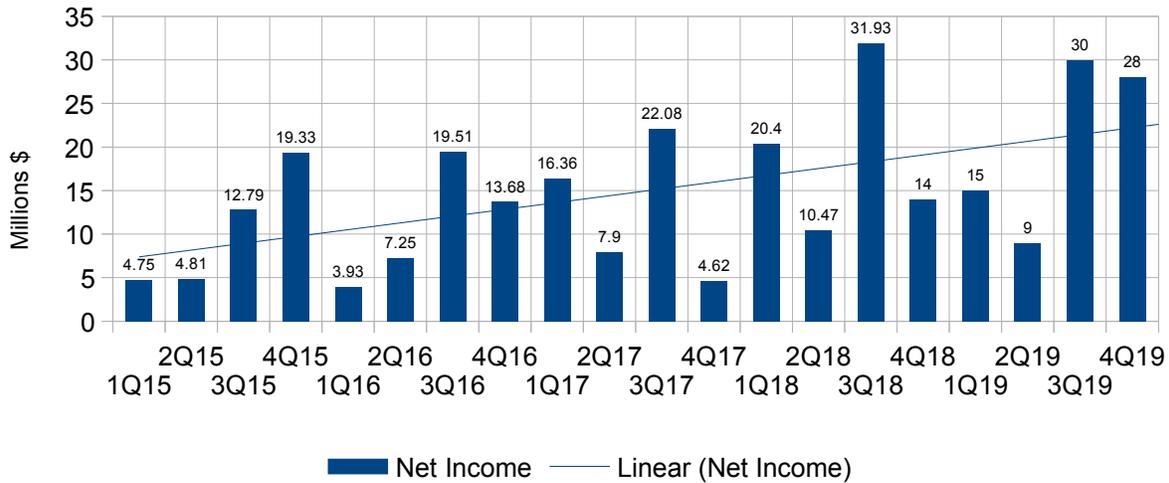
2014 To 2019 Est.



Income from operations estimated to increase 13.6% in 2019. Notice it will need a huge third and fourth quarter in 2019 to get there. So those two quarters will be much better with lower margins and at least a 10% tariff?

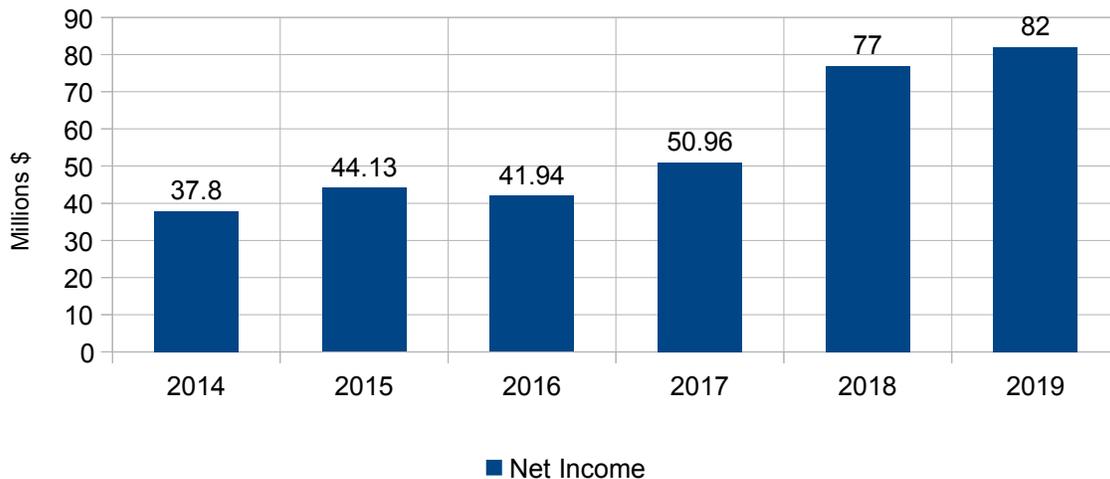
IRBT Net Income

2015 To 2019 Est.



IRBT Net Income

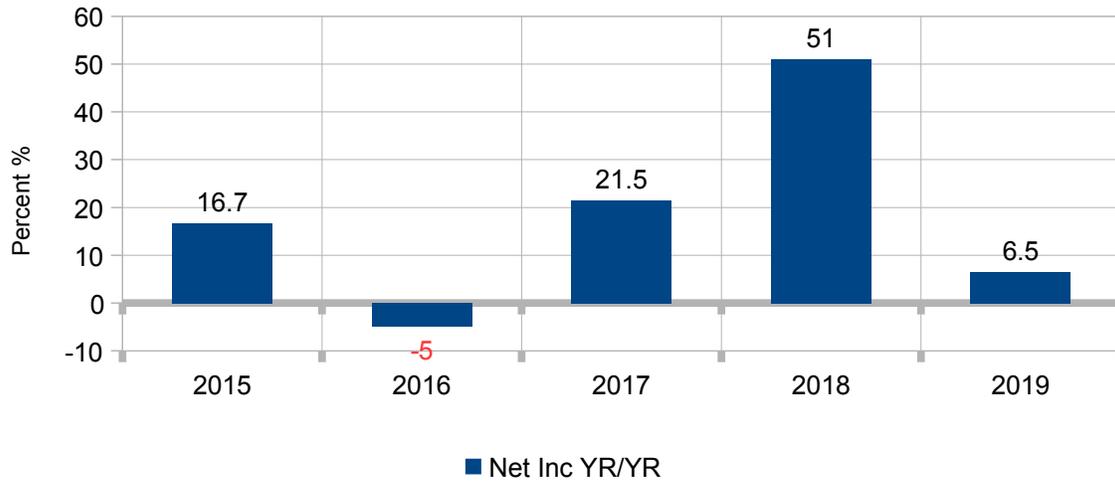
2014 To 2019 Est.



Same story with net income, need a big second half of 2019 to meet estimates. The first AND second quarters of both operating income and net income will be below 2018! And the third quarter will also be lower for net income.

IRBT YR/YR Net Income Growth %

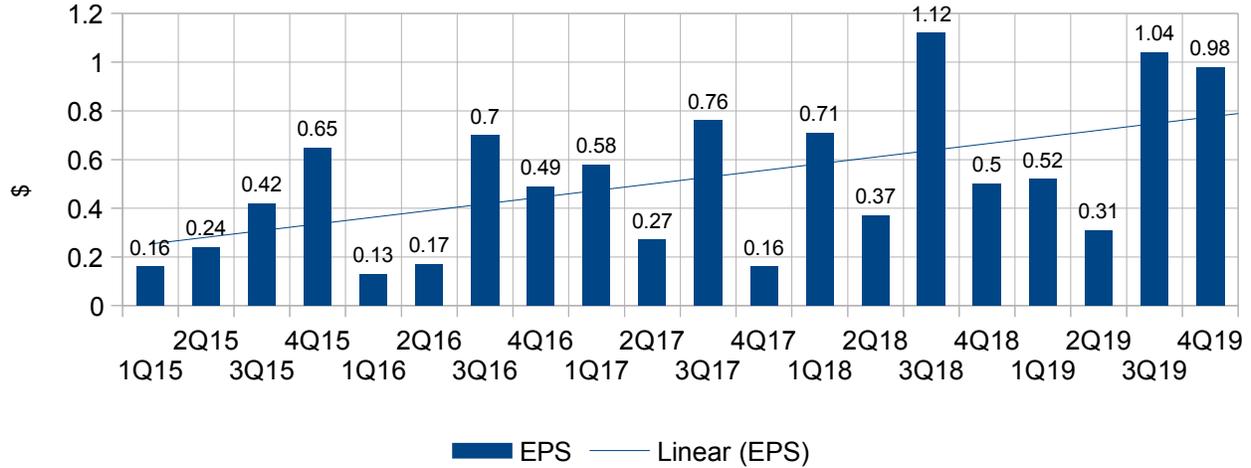
2015 To 2019 Est.



Sorry, but 6.5% net income growth, at best, is nothing to get excited about and certainly not worth paying over 30 times earnings for. This is nothing short of a collapse in the growth story.

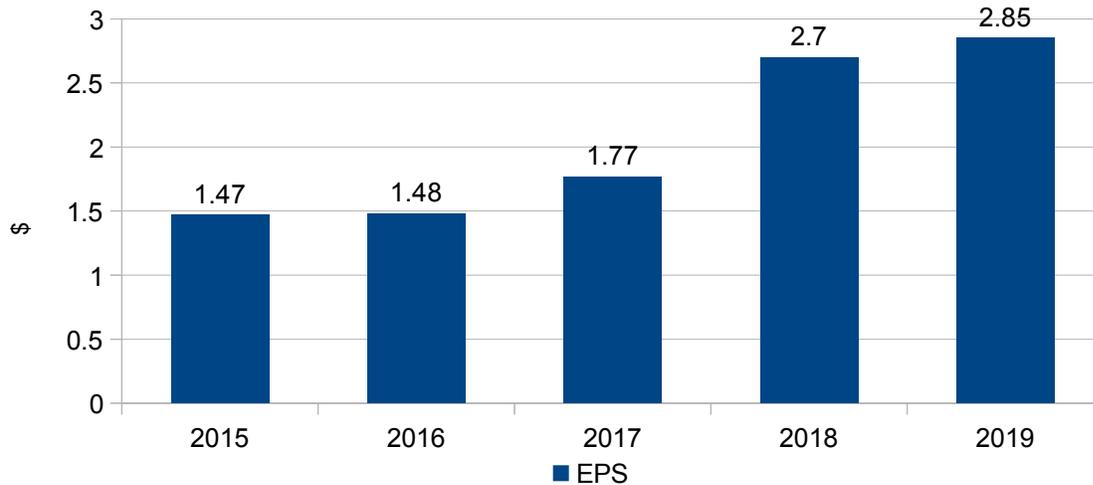
IRBT Earnings Per Share

2015 To 2019 Est.



IRBT Earnings Per Share

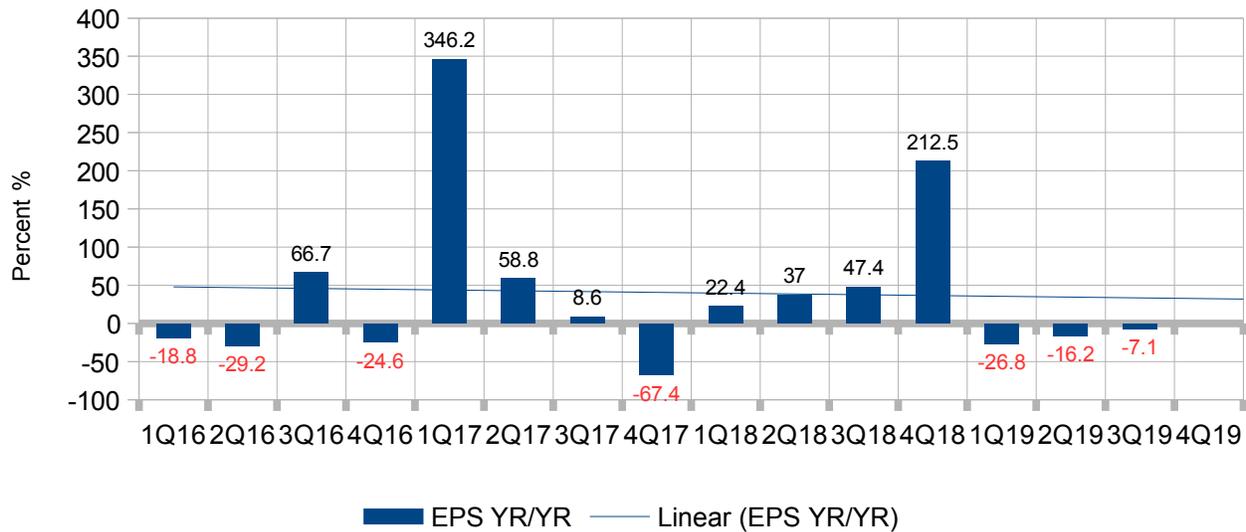
2015 To 2019 Est.



In 2018, EPS should increase 52%, from \$1.77 to \$2.70, but that drops to 5.5% in 2019!
FIVE PERCENT! Why is this trading at over 30 times again?

IRBT YR/YR EPS Growth %

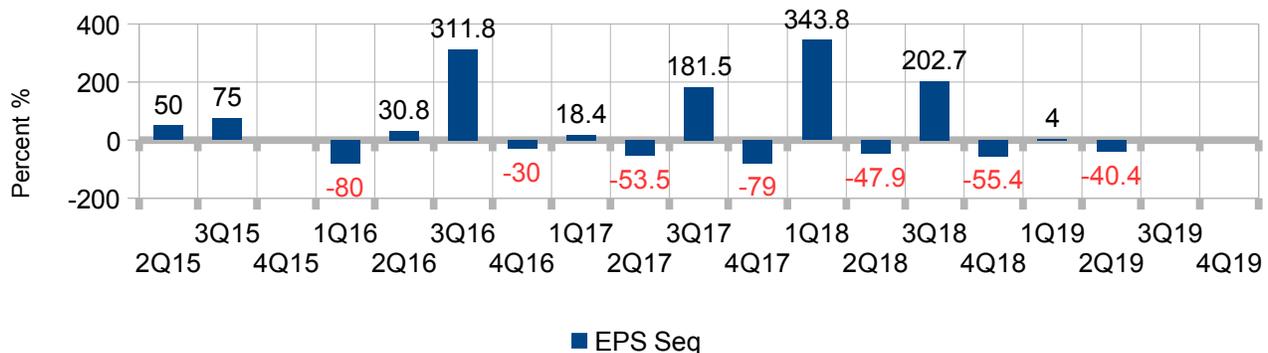
2016 To 2019 Est.



The first three quarters of 2019 will show NEGATIVE earnings growth! So, it is going to take a monster fourth quarter to make the number. We are skeptical, and even if they get there, its only FIVE PERCENT growth! The huge EPS growth in 4Q18 of 212% is only because the 4Q17 was a disaster. That 212% is \$0.50 vs \$0.16, and that 50 cents is down from previous estimates of \$0.94.

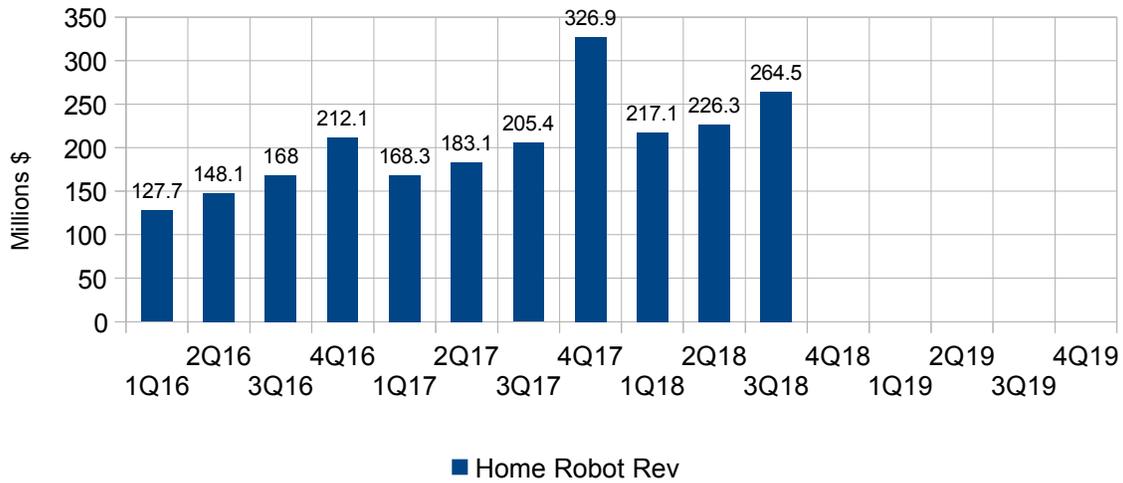
IRBT Sequential EPS Growth %

2015 To 2019 Est.



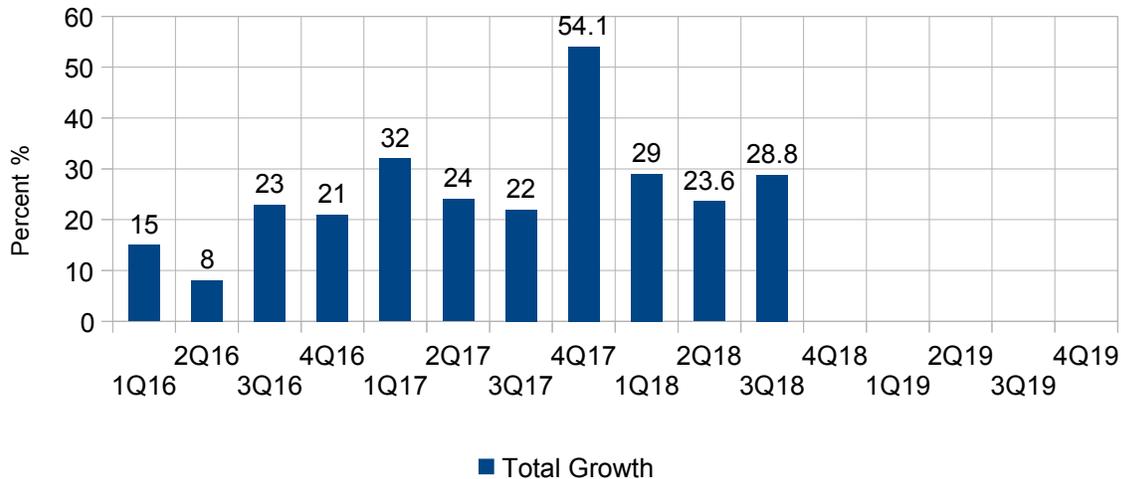
IRBT Home Robot Revenue

2016 To 2019 Est.



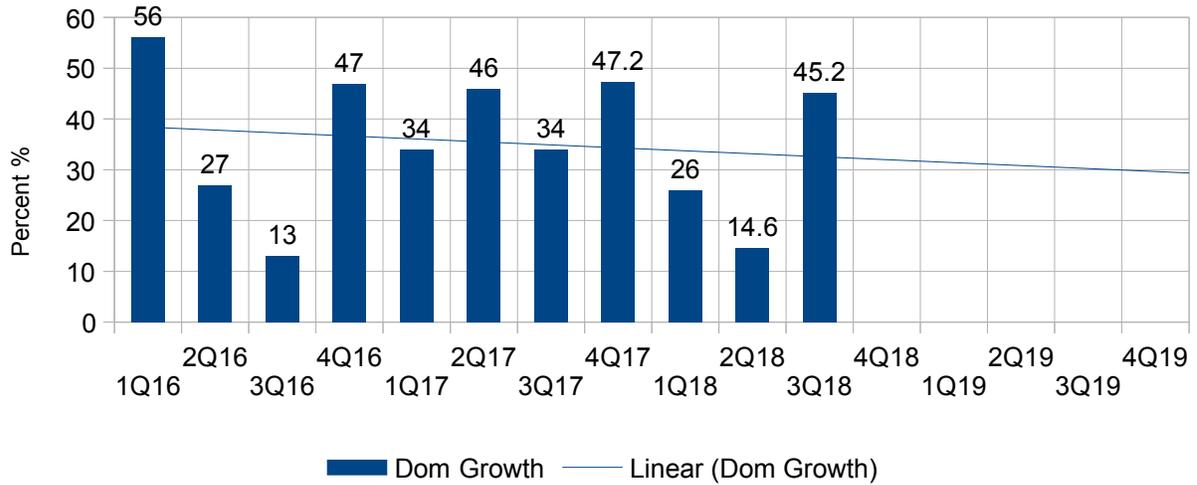
IRBT Total Robot Growth %

2016 To 2018

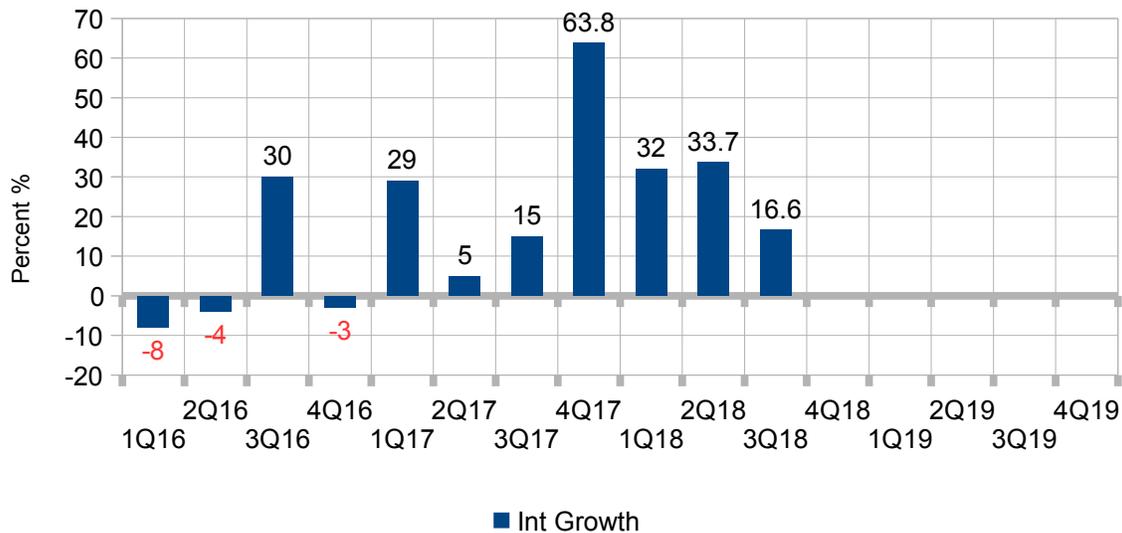


Domestic Robot Growth %

2016 To 2019 Est.

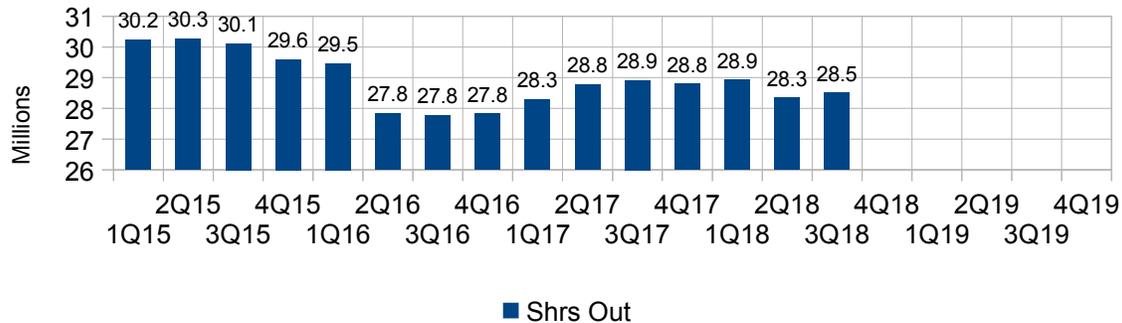


IRBT International Robot Growth %



Domestic robot revenue growth is actually trending down, but the international market is bigger.

IRBT Shares Outstanding (FD)



Conclusion

IRBT was a fast growing company trading at a high multiple. **Now, it is a much slower growing company with the same high multiple.** We have had great success shorting these kinds of consumer product companies in the past. They almost always work. That said, the short interest is 7 million shares so there can be up days on silly news like today's announcement of a collaboration with Google [Smart Map your home](#) which moved the stock up 9.2%? Short the rallies, take some profit on the dips.

This company is now too expensive for value investors and too slow of a grower for the momentum investors. Margins are staring to decline.

Management raised its 2018 EPS guide to \$2.55-\$2.75 from \$2.30-\$2.50 and revenue guidance to \$1.08B-\$1.09B (up 23%) from \$1.06-\$1.08B. That raised guidance implies 4Q18 EPS of \$0.36-\$0.56 vs \$0.88. Ooops! The raised revenue guidance of 23% implies 4Q18 revenue of \$372M-\$382M vs consensus of \$385.1M. Ooops!

So, that raised guidance caused the street to slash 4Q18 EPS from \$0.94 to \$0.50! Ooops! The street has raised 2019 revenue estimates by 2% to \$1.27B, but cut 2019 EPS 6.6% from \$3.05 to \$2.85. We think a P/E of 25 on \$3.85 in EPS is a fair valuation in a rising interest rate environment, which equates to a \$71 price target. It is very possible that margins continue to decline and the revenue growth slows even more than the street expects. If that were to occur a 20 P/E on \$2.50 in EPS would equal a \$50 stock. There is a lot of risk to the downside in this stock. It might be a bumpy ride to get there, but the risk is to the downside with net income and earnings growing only 5%. Our short term price target is \$75-\$78, our medium price target is \$70-\$72, our ultimate price target is \$50-\$60.

	For the three months ended		For the nine months ended	
	September 29,	September 30,	September 29,	September 30,
	2018	2017	2018	2017
Revenue	\$ 264,534	\$ 205,399	\$ 707,919	\$ 557,014
Cost of revenue:				
Cost of product revenue	124,754	100,800	324,967	272,068
Amortization of intangible assets	4,574	2,216	14,035	5,329
Total cost of revenue	129,328	103,016	339,002	277,397
Gross margin	135,206	102,383	368,917	279,617
Operating expenses:				
Research and development	35,309	28,843	103,178	80,518
Selling and marketing	39,030	28,473	116,269	91,171
General and administrative	23,329	21,002	72,630	58,137
Amortization of intangible assets	263	173	805	173
Total operating expenses	97,931	78,491	292,882	229,999
Operating income	37,275	23,892	76,035	49,618
Other income, net	337	2,601	2,363	4,290
Income before income taxes	37,612	26,493	78,398	53,908
Income tax expense	5,683	4,411	15,597	7,565
Net income	\$ 31,929	\$ 22,082	\$ 62,801	\$ 46,343
Net income per share:				
Basic	\$ 1.16	\$ 0.80	\$ 2.27	\$ 1.68
Diluted	\$ 1.12	\$ 0.76	\$ 2.19	\$ 1.61
Number of shares used in per share calculations:				
Basic	27,493	27,739	27,692	27,520
Diluted	28,506	28,916	28,629	28,719

iRobot Corporation
Condensed Consolidated Balance Sheets
(unaudited, in thousands)

	September 29, 2018	December 30, 2017
Assets		
Cash and cash equivalents	\$ 100,122	\$ 128,635
Short term investments	34,994	37,225
Accounts receivable, net	109,583	142,829
Inventory	160,752	106,932
Other current assets	33,732	19,105
Total current assets	439,183	434,726
Property and equipment, net	54,198	44,579
Deferred tax assets	31,785	31,531
Goodwill	118,805	121,440
Intangible assets, net	29,385	44,712
Other assets	15,647	14,534
Total assets	\$ 689,003	\$ 691,522
Liabilities and stockholders' equity		
Accounts payable	\$ 103,143	\$ 116,316
Accrued expenses	62,851	73,647
Deferred revenue and customer advances	4,719	7,761
Total current liabilities	170,713	197,724
Deferred tax liabilities	5,720	9,539
Other long-term liabilities	8,992	13,932
Total long-term liabilities	14,712	23,471
Total liabilities	185,425	221,195
Stockholders' equity	503,578	470,327
Total liabilities and stockholders' equity	\$ 689,003	\$ 691,522

	For the nine months ended	
	September 29,	September 30,
	2018	2017
Cash flows from operating activities:		
Net income	\$ 62,801	\$ 46,343
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	27,077	14,523
Gain on business acquisition	-	(2,243)
Stock-based compensation	18,969	14,069
Deferred income taxes, net	(4,296)	(3,226)
Deferred rent	1,171	-
Other	(216)	(774)
Changes in operating assets and liabilities — (use) source		
Accounts receivable	31,930	(10,957)
Inventory	(54,619)	(23,944)
Other assets	(15,818)	(11,099)
Accounts payable	(10,512)	20,824
Accrued expenses	(12,086)	7,034
Deferred revenue and customer advances	(1,436)	(965)
Long-term liabilities	(2,672)	1,513
Net cash provided by operating activities	40,293	51,098
Cash flows from investing activities:		
Additions of property and equipment	(25,284)	(16,630)
Change in other assets	(2,263)	(1,374)
Proceeds from sale of equity investment	856	1,056
Cash paid for business acquisition, net of cash acquired	-	(16,524)
Purchases of investments	(6,438)	(7,034)
Sales and maturities of investments	10,500	10,500
Net cash used in investing activities	(22,629)	(30,006)
Cash flows from financing activities:		
Proceeds from employee stock plans	7,948	8,990
Income tax withholding payment associated with restricted stock vesting	(3,532)	(2,974)
Stock repurchases	(50,000)	-
Net cash (used in) provided by financing activities	(45,584)	6,016
Effect of exchange rate changes on cash and cash equivalents	(593)	155
Net (decrease) increase in cash and cash equivalents	(28,513)	27,263
Cash and cash equivalents, at beginning of period	128,635	214,523
Cash and cash equivalents, at end of period	\$ 100,122	\$ 241,786

	For the three months ended		For the nine months ended	
	September 29,	September 30,	September 29,	September 30,
	2018	2017	2018	2017
Revenue: *				
Consumer	\$ 264,534	\$ 205,360	\$ 707,919	\$ 556,757
Domestic	\$ 127,240	\$ 87,626	\$ 345,628	\$ 269,998
International	\$ 137,294	\$ 117,734	\$ 362,291	\$ 286,758
Gross Margin Percent	51.1%	49.8%	52.1%	50.2%
Consumer units shipped*	1,087	906	2,855	2,358
Vacuum	942	774	2,473	1,994
Mopping	145	131	382	362
Consumer revenue**	\$ 265	\$ 205	\$ 708	\$ 557
Vacuum***	\$ 242	\$ 186	\$ 647	\$ 504
Mopping***	\$ 23	\$ 21	\$ 61	\$ 55
Average gross selling prices for robot units - Consumer	\$ 276	\$ 249	\$ 289	\$ 260
Days sales outstanding	38	35	38	35
Days in inventory	113	82	113	82
Headcount	1,003	798	1,003	798

* in thousands

** in millions

*** includes accessory revenue

iRobot Corporation (IRBT) ★ In watchlist
NasdaqGS - NasdaqGS Real Time Price. Currency in USD
88.17 +7.43 (+9.20%) **88.17** 0.00 (0.00%)
At close: 4:00PM EDT After hours: 4:50PM EDT



EPS Estimate Cuts

	<u>Old</u>	<u>New</u>	<u>Difference</u>
4Q18:	\$0.94	\$0.50	-46.8%
1Q19:	\$0.71	\$0.52	-26.8%
2Q19:	\$0.33	\$0.31	-6.1%
3Q19:	\$0.68	\$1.04	+52.9% ???
4Q19:	\$1.32	\$0.98	-25.8%

BTW: The analyst that just cut these numbers of course has a buy on the stock and a \$95 price target!

We recommend scaling into the short position over time.