

IROBOT CORP  
Form 10-Q  
August 01, 2008

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

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED June 28, 2008  
OR**

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

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No   
The number of shares outstanding of the Registrant's Common Stock as of July 25, 2008 was 24,689,521.

**iROBOT CORPORATION**  
**FORM 10-Q**  
**THREE AND SIX MONTHS ENDED JUNE 28, 2008**  
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The accompanying notes are an integral part of the consolidated financial statements.

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**iROBOT CORPORATION**  
**Consolidated Balance Sheets**  
(in thousands)

	<b>June 28, 2008 (unaudited)</b>	<b>December 29, 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 14,760	\$ 26,735
Short term investments	1,200	16,550
Accounts receivable, net of allowance of \$350 and \$65 at June 28, 2008 and December 29, 2007, respectively	24,253	47,681
Unbilled revenue	2,190	2,244
Inventory, net	43,288	45,222
Deferred tax assets	5,905	5,905
Other current assets	10,384	2,268
<b>Total current assets</b>	<b>101,980</b>	<b>146,605</b>
Property and equipment, net	24,612	15,694
Deferred tax assets	4,293	4,293
Long term investments	13,639	
Other assets	2,500	2,500
<b>Total assets</b>	<b>\$ 147,024</b>	<b>\$ 169,092</b>
<b>LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 23,965	\$ 44,697
Accrued expenses	8,166	7,987
Accrued compensation	6,625	4,603
Deferred revenue	950	1,578
<b>Total current liabilities</b>	<b>39,706</b>	<b>58,865</b>
Long term liabilities	4,659	
Commitments and contingencies (Note 6):		
Redeemable convertible preferred stock, 5,000 shares authorized and zero outstanding at June 28, 2008 and December 29, 2007		
Common stock, \$0.01 par value, 100,000 and 100,000 shares authorized and 24,687 and 24,495 issued and outstanding at June 28, 2008 and December 29, 2007, respectively	247	245
Additional paid-in capital	125,747	122,318
Deferred compensation	(508)	(685)
Accumulated deficit	(20,169)	(11,651)
Accumulated other comprehensive loss	(2,658)	

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Total stockholders' equity	102,659	110,227
Total liabilities, redeemable convertible preferred stock and stockholders' equity	\$ 147,024	\$ 169,092

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

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June</b>		<b>June 28,</b>	
	<b>28,</b>	<b>June 30,</b>	<b>2008</b>	<b>June 30,</b>
	<b>2008</b>	<b>2007</b>		<b>2007</b>
<b>Revenue:</b>				
Product revenue	\$ 60,676	\$ 41,361	\$ 111,251	\$ 75,482
Contract revenue	6,526	5,653	13,253	11,019
Total revenue	67,202	47,014	124,504	86,501
<b>Cost of revenue:</b>				
Cost of product revenue (1)	44,382	27,238	80,577	50,724
Cost of contract revenue (1)	6,352	4,552	12,099	9,436
Total cost of revenue	50,734	31,790	92,676	60,160
Gross profit	16,468	15,224	31,828	26,341
<b>Operating expenses:</b>				
Research and development (1)	4,718	4,179	8,691	8,335
Selling and marketing (1)	13,471	10,944	24,929	18,993
General and administrative (1)	7,340	5,752	14,118	11,079
Total operating expenses	25,529	20,875	47,738	38,407
Operating loss	(9,061)	(5,651)	(15,910)	(12,066)
Other income, net	242	887	737	1,818
Loss before income taxes	(8,819)	(4,764)	(15,173)	(10,248)
Income tax expense (benefit)	(4,306)	12	(6,655)	29
Net loss	\$ (4,513)	\$ (4,776)	\$ (8,518)	\$ (10,277)
Net loss per share				
Basic and diluted	\$ (0.18)	\$ (0.20)	\$ (0.35)	\$ (0.43)
Number of shares used in per share calculations				
Basic and diluted	24,610	24,226	24,561	24,064

(1) Total stock-based compensation recorded in the three and six months ended

June 28, 2008  
and June 30,  
2007 included  
in the above  
figures breaks  
down by  
expense  
classification as  
follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 28, 2008</b>	<b>June 30, 2007</b>	<b>June 28, 2008</b>	<b>June 30, 2007</b>
Cost of product revenue	\$ 216	\$ 239	\$ 370	\$ 359
Cost of contract revenue	114	134	173	211
Research and development	128	127	95	118
Selling and marketing	267	450	428	607
General and administrative	808	578	1,405	890
Total stock-based compensation	\$ 1,533	\$ 1,528	\$ 2,471	\$ 2,185

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

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

	<b>Six Months Ended</b>	
	<b>June 28, 2008</b>	<b>June 30, 2007</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (8,518)	\$ (10,277)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,291	2,459
Loss on disposal of fixed assets	68	35
Stock-based compensation	2,471	2,185
Non-cash director deferred compensation	47	55
Changes in working capital (use) source		
Accounts receivable	23,428	10,831
Unbilled revenue	54	472
Inventory	1,934	(1,118)
Other assets	(8,116)	883
Accounts payable	(20,732)	(579)
Accrued expenses	179	(2,021)
Accrued compensation	2,022	286
Deferred revenue	(628)	1,457
Change in long term liabilities	4,659	
Net cash provided by operating activities	159	4,668
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(12,277)	(3,921)
Purchases of investments	(29,997)	(22,000)
Sales of investments	29,050	26,800
Net cash provided by (used in) investing activities	(13,224)	879
<b>Cash flows from financing activities:</b>		
Income tax withholding payment associated with stock option exercise		(1,588)
Proceeds from stock option exercises	732	719
Tax benefit of disqualifying dispositions	358	
Net cash provided by (used in) financing activities	1,090	(869)
Net increase (decrease) in cash and cash equivalents	(11,975)	4,678
Cash and cash equivalents, at beginning of period	26,735	5,583
Cash and cash equivalents, at end of period	\$ 14,760	\$ 10,261



**Supplemental disclosure of cash flow information:**

Cash paid for interest	\$	41	\$	
Cash paid for income taxes		38		112

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

During the six months ended June 28, 2008 and June 30, 2007, the Company transferred \$146 and \$481, respectively, of inventory to fixed assets.

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

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**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 June 28, 2008 and for the three and six months ended June 28, 2008 and June 30, 2007 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 29, 2007, filed with the SEC on February 25, 2008.

In the opinion of management, all adjustments necessary to present a fair statement of financial position as of June 28, 2008 and results of operations and cash flows for the periods ended June 28, 2008 and June 30, 2007 have been made. The results of operations and cash flows for any interim period are not necessarily indicative of the operating results and cash flows for the full fiscal year or any future periods.

***Use of Estimates***

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

***Fiscal Year-End***

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

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

The Company derives its revenue from product sales, government research and development contracts, and commercial research and development contracts. The Company sells products directly to customers and indirectly through resellers and distributors. The Company recognizes revenue from sales of home robots under the terms of the customer agreement upon transfer of title 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.

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

The Company accounts for share-based payments to employees, including grants of employee stock options and awards in the form of restricted shares and restricted stock units under the provisions of SFAS No. 123(R), *Share-Based Payment* ( SFAS 123(R) ). Under the provisions of SFAS 123(R), the Company establishes the fair value of each option grant using the Black-Scholes option-pricing model. SFAS 123(R) requires the recognition of the fair value of share-based payments as a charge against earnings. The Company recognizes share-based payment expense over the requisite service period of the underlying grants and awards. Based on the provisions of SFAS 123(R), the Company's share-based payment awards are accounted for as equity instruments.

***Net Income Per Share***

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June</b>	<b>June 30,</b>	<b>June</b>	<b>June 30,</b>
	<b>28,</b>	<b>2007</b>	<b>28,</b>	<b>2007</b>
	<b>2008</b>		<b>2008</b>	<b>2007</b>
	<b>(In thousands, except per share data)</b>			
Net loss	\$ (4,513)	\$ (4,776)	\$ (8,518)	\$ (10,277)

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Diluted weighted average shares outstanding	24,610	24,226	24,561	24,064
Basic and diluted loss per share	\$ (0.18)	\$ (0.20)	\$ (0.35)	\$ (0.43)

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

Potentially dilutive securities representing approximately 0.9 million and 1.2 million shares of common stock for the quarters ended June 28, 2008 and June 30, 2007, respectively, and 1.0 million and 1.4 million shares of common stock for the six months ended June 28, 2008 and June 30, 2007, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

**Income Taxes**

Deferred taxes are determined based on the difference between the 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.

In fiscal 2007, the Company completed an analysis of historical and projected future profitability which resulted in the full release of the valuation allowance relating to federal deferred tax assets. The Company continues to maintain a valuation allowance against state deferred tax assets due to less certainty of their realizability given the shorter expiration period associated with them and the generation of state tax credits in excess of the state tax liability. At June 28, 2008, the Company has total deferred tax assets of \$12.8 million and a valuation allowance of \$2.6 million resulting in a net deferred tax asset of \$10.2 million.

**Comprehensive Loss**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June</b>		<b>June</b>	<b>June</b>
	<b>28,</b>	<b>June 30,</b>	<b>28,</b>	<b>30,</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(In thousands)</b>			
Net loss, as reported	\$ (4,513)	\$ (4,776)	\$ (8,518)	\$ (10,277)
Unrealized losses on investments	(562)		(2,658)	
Total comprehensive loss	\$ (5,075)	\$ (4,776)	\$ (11,176)	\$ (10,277)

**Fair Value Measurements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. The Company has adopted the provisions of SFAS 157 as of December 30, 2007, for financial instruments. Although the adoption of SFAS 157 did not materially impact its financial condition, results of operations, or cash flow, the Company is now required to provide additional disclosures as part of its financial statements.

SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The Company has invested in auction rate security instruments, which have been historically classified as available for sale securities and reflected at fair value. Due to recent events in credit markets, however, the auction events for all of these instruments currently held by the Company began to fail during the first quarter of 2008 and each such

auction since then has failed. Therefore, the fair values of these securities are estimated utilizing a discounted cash flow model which also considers limited secondary market indicators as of June 28, 2008. These analyses consider, among other items, the collateralization underlying the security investments, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company.

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(unaudited)

As a result of the temporary declines in fair value for the Company's auction rate securities, which the Company attributes to liquidity issues of the securities rather than credit issues, it has recorded an unrealized loss of \$2.7 million to Accumulated other comprehensive loss on the balance sheet. The auction rate security instruments held by the Company at June 28, 2008 were in securities collateralized by student loan portfolios, the majority of which are guaranteed by the United States government. Historically, these securities have been classified as Short term investments, and at December 29, 2007, the Company held auction rate securities with a par value and fair value of \$16.6 million. Due to the Company's belief that the market for these student loan collateralized instruments may take in excess of twelve months to fully recover, the Company has classified \$13.6 million of these investments as noncurrent and has included them in Long term investments on the unaudited Condensed Consolidated Balance Sheet at June 28, 2008. Any future fluctuation in fair value related to these instruments that the Company deems to be temporary, including any recoveries of the \$2.7 million write-down, would be recorded to Accumulated other comprehensive income (loss). If the Company determines that any future valuation adjustment was other than temporary, it would record a charge to earnings as appropriate. The Company received information during the quarter ended June 28, 2008 that one issuer had refinanced its auction rate bonds and intended to call its outstanding issues at par. The Company held \$1.2 million of the auction rate bonds to be called. These bonds were called at par on July 7, 2008. Given the expectation of a pending call, the Company classified these bonds as a short-term investment and recorded their value at par as of June 28, 2008.

The Company's assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS 157 at June 28, 2008, were as follows:

<b>Description</b>	<b>Fair Value Measurements as of June 28, 2008</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Assets:			
Money Market Accounts	\$ 13,776	\$	\$
Auction Rate Securities			14,839
Total assets measured at fair value	\$ 13,776		\$ 14,839

The following table presents the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in SFAS 157 at June 28, 2008:

	<b>Fair Value Measurements of Assets using Level 3 inputs Auction Rate Securities</b>	
	<b>(In thousands)</b>	
Beginning balance at December 29, 2007	\$	
Transfers to Level 3		17,497
Total losses (realized or unrealized) Included in other comprehensive loss		(2,658)
Ending balance at June 28, 2008	\$	14,839

***Recent Accounting Pronouncements***

In September 2006, FASB issued SFAS 157, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. However, on February 12, 2008, FASB issued FSP FAS 157-2, which delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). This FSP partially defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. Effective fiscal 2008, the Company has adopted SFAS 157 except as it applies to those nonfinancial assets and nonfinancial liabilities as noted in FSP FAS 157-2. The Company is currently evaluating the potential impact of adoption of FSP FAS 157-2 and has not yet determined the impact, if any, that its adoption will have on its results of operations or financial condition.



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(unaudited)

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value ( fair value option ). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, SFAS 159 specifies that unrealized gains and losses for that instrument be reported in earnings at each subsequent reporting date. SFAS 159 was effective for the Company on January 1, 2008. The Company did not apply the fair value option to any of its outstanding instruments and therefore, SFAS 159 did not have an impact on the Company's consolidated financial statements.

In December 2007, FASB issued SFAS No. 141 (revised 2007), *Business Combinations*( SFAS 141R ) and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51* ( SFAS 160 ). SFAS 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. The provisions of SFAS 141R and SFAS 160 are effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating the potential impact of adoption of SFAS 141R and SFAS 160 and has not yet determined the impact, if any, that their adoption will have on its results of operations or financial condition.

In March 2008, FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( SFAS 161 ). The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the potential impact of adoption of SFAS 161 and has not yet determined the impact, if any, that its adoption will have on its results 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. Inventory**

Inventory consists of the following at:

	<b>June 28, 2008</b>	<b>December 29, 2007</b>
	<b>(In thousands)</b>	
Raw materials	\$ 3,878	\$ 1,641
Work in process	540	517
Finished goods	38,870	43,064
	<b>\$ 43,288</b>	<b>\$ 45,222</b>

**4. 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

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(unaudited)

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 June 28, 2008, there were 1,636,936 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. 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.

**5. Accrued Expenses**

Accrued expenses consist of the following at:

	<b>June 28, 2008</b>	<b>December 29, 2007</b>
	<b>(In thousands)</b>	
Accrued warranty	\$ 3,257	\$ 2,491
Accrued direct fulfillment costs	967	1,953
Accrued rent	1,074	197
Accrued sales commissions	774	1,074
Accrued accounting fees	433	361
Accrued other	1,661	1,911
	<b>\$ 8,166</b>	<b>\$ 7,987</b>

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

The Company leases its facilities. Rental expense under operating leases for the three months ended June 28, 2008 and June 30, 2007 amounted to \$1.5 million and \$0.5 million, respectively, and for the six months ended June 28, 2008 and June 30, 2007 amounted to \$2.1 million and \$1.0 million, respectively. The Company recorded \$0.7 million of expense in the three month period ended June 28, 2008 for remaining lease commitments, net of estimated sublease income, at our former corporate headquarters in Burlington, MA. Future minimum rental payments under operating leases were as follows as of June 28, 2008:

	<b>Operating Leases (In thousands)</b>
Remainder of 2008	\$ 1,818
2009	2,341
2010	2,229
2011	2,211
2012	2,189
Thereafter	15,307

Total minimum lease payments	\$ 26,095
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***Sales Taxes***

The Company collects and remits sales tax in jurisdictions in which it has a physical presence or it believes a nexus exists, which therefore obligates the Company to collect and remit sales tax. The Company is not currently aware of any asserted claims for sales tax liabilities for prior taxable periods. The Company is currently being audited by one state but does not believe this is likely to result in any material liability.

The Company has conducted an evaluation of whether it has established a nexus in various jurisdictions with respect to sales tax. In conjunction with this evaluation, the Company has approached several states pursuant to voluntary disclosure arrangements. As a result of this process, the Company is currently in negotiations with one state where nexus is believed to be probable and has recorded a liability for potential exposure in this one

**Table of Contents****iROBOT CORPORATION**Notes To Consolidated Financial Statements Continued  
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jurisdiction. The Company continues to analyze possible sales tax exposure, but does not currently believe that any individual claim or aggregate claims that might arise will ultimately have a material effect on its consolidated results of operations, financial position or cash flows.

**Guarantees and Indemnification Obligations**

The Company enters into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, the Company indemnifies and agrees to reimburse the indemnified party for losses incurred by the indemnified party, generally the Company's customers, in connection with any patent, copyright, trade secret or other proprietary right infringement claim by any third party with respect to the Company's products. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of June 28, 2008 and June 30, 2007, respectively.

**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 5) in the accompanying balance sheets.

Activity related to the warranty accrual was as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)		(In thousands)	
Balance at beginning of period	\$ 2,524	\$ 2,497	\$ 2,491	\$ 2,462
Provision	1,704	1,407	3,245	3,391
Warranty usage(*)	(971)	(1,483)	(2,479)	(3,432)
Balance at end of period	\$ 3,257	\$ 2,421	\$ 3,257	\$ 2,421

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

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

The Company operates in two reportable segments, the home robots division and government and industrial division.

The nature of products and types of customers for the two segments vary significantly. As such, the segments are managed separately.

**Home Robots**

The Company's home robots 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 loss before income taxes:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 28, 2008</b>	<b>June 30, 2007</b>	<b>June 28, 2008</b>	<b>June 30, 2007</b>
	<b>(In thousands)</b>		<b>(In thousands)</b>	
<b>Revenue:</b>				
Home Robots	\$ 41,705	\$ 17,197	\$ 71,853	\$ 36,638
Government & Industrial	25,497	29,817	52,651	49,863
Total revenue	67,202	47,014	124,504	86,501
<b>Cost of revenue:</b>				
Home Robots	30,946	11,805	53,025	25,369
Government & Industrial	19,788	19,985	39,651	34,791
Total cost of revenue	50,734	31,790	92,676	60,160
<b>Gross profit:</b>				
Home Robots	10,759	5,392	18,828	11,269
Government & Industrial	5,709	9,832	13,000	15,072
Total gross profit	16,468	15,224	31,828	26,341
<b>Research and development</b>				
Other	4,718	4,179	8,691	8,335
<b>Selling and marketing</b>				
Other	13,471	10,944	24,929	18,993
<b>General and administrative</b>				
Other	7,340	5,752	14,118	11,079
<b>Other income, net</b>				
Other	242	887	737	1,818
<b>Loss before income taxes</b>				
Other	\$ (8,819)	\$ (4,764)	\$ (15,173)	\$ (10,248)

*Geographic Information*

For the three months ended June 28, 2008 and June 30, 2007, sales to non-U.S. customers accounted for 27.6% and 16.6% of total revenue, respectively, and for the six months ended June 28, 2008 and June 30, 2007, sales to non-U.S. customers accounted for 23.9% and 11.8% of total revenue, respectively.

*Significant Customers*

For the three months ended June 28, 2008 and June 30, 2007, U.S. federal government orders, contracts and subcontracts accounted for 35.5% and 50.8% of total revenue, respectively, and for the six months ended June 28, 2008 and June 30, 2007, U.S. federal government orders, contracts and subcontracts accounted for 39.3% and 48.7% 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 29, 2007, 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, Verro and ConnectR products, PackBot tactical military robots, our home robot and government and industrial robots divisions, our competition, our strategy, our market position, market acceptance of our products, seasonal factors, revenue recognition, our profits, growth of our revenues, composition of our revenues, our cost of revenues, operating expenses, selling and marketing expenses, general and administrative expenses, research and development expenses, and compensation costs, our projected income tax rate, our ability to attract and retain qualified personnel, our credit facility and equipment facility, our valuations of investments, valuation and composition of our stock-based awards, SFAS 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 29, 2007, 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 robot and Scooba floor washing robot perform time consuming domestic chores in the home, while our Looj gutter cleaning robot and Verro pool cleaning robot perform tasks outside the home, 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. 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 June 28, 2008, we had 482 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, reducing the time, cost and risk of product development. Our significant expertise in robot design and engineering, combined with our management team's experience in military and consumer markets, positions us to capitalize on the expected growth in the market for robots.

Although we have successfully launched consumer and 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 consumer 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 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 six month periods ended June 28, 2008 and June 30, 2007:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 28, 2008</b>	<b>June 30, 2007</b>	<b>June 28, 2008</b>	<b>June 30, 2007</b>
Revenue				
Product revenue	90.3%	88.0%	89.4%	87.3%
Contract revenue	9.7	12.0	10.6	12.7
Total revenue	100.0	100.0	100.0	100.0
Cost of Revenue				
Cost of product revenue	66.0	57.9	64.7	58.6
Cost of contract revenue	9.5	9.7	9.7	10.9
Total cost of revenue	75.5	67.6	74.4	69.5
Gross profit	24.5	32.4	25.6	30.5
Operating Expenses				
Research and development	7.0	8.9	7.0	9.6
Selling and marketing	20.1	23.3	20.0	22.0
General and administrative	10.9	12.2	11.4	12.8
Total operating expenses	38.0	44.4	38.4	44.4
Operating loss	(13.5)	(12.0)	(12.8)	(13.9)
Other income, net	0.4	1.9	0.6	2.1
Loss before income taxes	(13.1)	(10.1)	(12.2)	(11.8)
Income tax expense (benefit)	(6.4)	0.1	(5.4)	0.1
Net loss	(6.7)%	(10.2)%	(6.8)%	(11.9)%

**Comparison of Three and Six Months Ended June 28, 2008 and June 30, 2007***Revenue*

	<b>Three Months Ended</b>				<b>Six Months Ended</b>			
	<b>June 28,</b>	<b>June 30,</b>	<b>Dollar</b>	<b>Percent</b>	<b>June 28,</b>	<b>June 30,</b>	<b>Dollar</b>	<b>Percent</b>
	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>Change</b>	<b>2008</b>	<b>2007</b>	<b>Change</b>	<b>Change</b>
	<b>(Dollars in thousands)</b>				<b>(Dollars in thousands)</b>			
Total revenue	\$67,202	\$47,014	\$20,188	42.9%	\$124,504	\$86,501	\$38,003	43.9%

Total revenue for the three months ended June 28, 2008 increased to \$67.2 million, or 42.9%, compared to \$47.0 million for the three months ended June 30, 2007. Revenue increased approximately \$24.5 million, or 142.5%, in our home robots business and decreased approximately \$4.3 million, or 14.5%, in our government and industrial business.

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The \$24.5 million increase in revenue from our home robots division for the three months ended June 28, 2008 was driven by a \$22.7 million increase in home floor care robots revenue due to a 140.5% increase in units shipped and a 6.5% increase in average selling prices, and a \$1.8 million increase in product life cycle revenue (spares and accessories), as compared to the three months ended June 30, 2007. Total home floor care robots shipped in the three months ended June 28, 2008 were approximately 237,000 units compared to approximately 99,000 units in the three months ended June 30, 2007. The \$4.3 million decrease in revenue from our government and industrial business for the three months ended June 28, 2008 as compared to three months ended June 30, 2007 was due to a \$5.5 million decrease in product sales of our military robots. This was driven by a 32.6% decrease in associated net average selling prices related to product mix primarily attributable to a shift of our military product line into lower priced models. This was partially offset by an 11.8% increase in units shipped, 170 units compared to 152 units, and an increase of \$0.9 million in recurring contract development revenue generated under funded research and development contracts.

Total revenue for the six months ended June 28, 2008 increased to \$124.5 million, or 43.9%, compared to \$86.5 million for the six months ended June 30, 2007. Revenue increased approximately \$35.2 million, or 96.1%, in our home robots business and increased approximately \$2.8 million, or 5.6%, in our government and industrial business.

The \$35.2 million increase in revenue from our home robots division for the six months ended June 28, 2008 was driven by a \$33.5 million increase in home floor care robots revenue due to a 78.6% increase in units shipped and a 15.2% increase in average selling prices, and a \$3.2 million increase in product life cycle revenue (spares and accessories), as compared to the six months ended June 30, 2007. Total home floor care robots shipped in the six months ended June 28, 2008 were approximately 407,000 units compared to approximately 227,000 units in the six months ended June 30, 2007. The \$2.8 million increase in revenue from our government and industrial business for the six months ended June 28, 2008 as compared to six months ended June 30, 2007 was due to an increase of \$2.2 million in recurring contract development revenue generated under funded research and development contracts and a \$0.5 million increase in product life cycle revenue. Product sales of our military robots increased \$0.1 million due to a 30.9% increase in units shipped, 326 compared to 249, offset by a 23.3% decrease in associated net average selling prices related to product mix primarily attributable to a shift of our military product line into lower priced models.

*Cost of Revenue*

	Three Months Ended				Six Months Ended			
	June 28, 2008	June 30, 2007	Dollar Change	Percent Change	June 28, 2008	June 30, 2007	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total cost of revenue	\$50,734	\$31,790	\$18,944	59.6%	\$92,676	\$60,160	\$32,516	54.0%
As a percentage of total revenue	75.5%	67.6%			74.4%	69.5%		

Total cost of revenue increased to \$50.7 million in the three months ended June 28, 2008, compared to \$31.8 million in the three months ended June 30, 2007. The increase is primarily due to higher costs associated with the 140.5% increase in home robot unit sales and an increase in home robots unit costs due to the introduction of our Roomba 500 product line in mid-2007 which has a higher unit cost than our previous model.

The home robots division cost of revenue increased as a percent of revenue by 5.5 percentage points in the three months ended June 28, 2008 as compared to the three months ended June 30, 2007. This increase was primarily attributable to a higher percentage of lower margin international revenue and a lower percentage of higher margin direct revenue, in the three months ended June 28, 2008 as compared to the three months ended June 30, 2007.

The government and industrial robots division cost of revenue increased as a percent of revenue by 10.6 percentage points in the three months ended June 28, 2008 as compared to the three months ended June 30, 2007. This was primarily due to an 11.0% increase in overhead costs as a percentage of revenue and an increase in contract costs,

partially offset by favorable product mix.

Total cost of revenue increased to \$92.7 million in the six months ended June 28, 2008, compared to \$60.2 million in the six months ended June 30, 2007. The increase is primarily due to higher costs associated with the 78.6% increase in home robot unit sales and an increase in home robots unit costs due to the introduction of our Roomba 500 product line in mid-2007 which has a higher unit cost than our previous model.

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The home robots division cost of revenue increased as a percent of revenue by 4.5 percentage points in the six months ended June 28, 2008 as compared to the six months ended June 30, 2007. This increase was primarily attributable to a higher percentage of lower margin international revenue and a lower percentage of higher margin direct revenue in the six months ended June 28, 2008 as compared to the six months ended June 30, 2007. In addition we had shipments to Linens N Things during the first quarter of 2008 for which we recorded costs, but did not recognize revenue due to collectability concerns given their financial condition and bankruptcy filing. These decreases were partially offset by improved warranty and favorable overhead absorption.

The government and industrial robots division cost of revenue increased as a percent of revenue by 5.5 percentage points in the six months ended June 28, 2008 as compared to the six months ended June 30, 2007. This was due to a 5.5% increase in overhead costs as a percentage of revenue.

*Gross Profit*

	Three Months Ended				Six Months Ended			
	June 28, 2008	June 30, 2007	Dollar Change	Percent Change	June 28, 2008	June 30, 2007	Dollar Change	Percent Change
	(Dollar in thousands)				(Dollars in thousands)			
Total gross profit	\$16,468	\$15,224	\$1,244	8.2%	\$31,828	\$26,341	\$5,487	20.8%
As a percentage of total revenue	24.5%	32.4%			25.6%	30.5%		

Gross profit increased \$1.2 million, or 8.2%, to \$16.5 million (24.5% of revenue) in the three months ended June 28, 2008, from \$15.2 million (32.4% of revenue) in the three months ended June 30, 2007. The decrease in gross profit as a percentage of revenue in the three months ended June 28, 2008 compared to the three months ended June 30, 2007 was the result of the home robots division gross profit decreasing 5.5 percentage points, and by the government and industrial division decreasing 10.5 percentage points. The 5.5 percentage point decrease in the home robots division is primarily attributable to a higher percentage of lower margin international revenue and a lower percentage of higher margin direct revenue in the three months ended June 28, 2008 as compared to the three months ended June 30, 2007. The government and industrial decrease was primarily the result of higher overhead expenses due to increased investments to drive scalability, increased facility costs and lower revenue.

Gross profit increased \$5.5 million, or 20.8%, to \$31.8 million (25.6% of revenue) in the six months ended June 28, 2008, from \$26.3 million (30.5% of revenue) in the six months ended June 30, 2007. The decrease in gross profit as a percentage of revenue in the six months ended June 28, 2008 compared to the six months ended June 30, 2007 was the result of the home robots division gross profit decreasing 4.5 percentage points, and by the government and industrial division decreasing 5.5 percentage points. The 4.5 percentage point decrease in the home robots division is primarily attributable to a higher percentage of lower margin international revenue and a lower percentage of higher margin direct revenue in the three months ended June 28, 2008 as compared to the three months ended June 30, 2007 and shipments to Linens N Things during the first quarter of 2008 for which we recorded costs but did not recognize revenue due to collectability concerns given their financial condition and bankruptcy filing. The government and industrial division decrease was primarily the result of higher overhead expenses due to increased investments to drive scalability and increased facility costs.

*Research and Development*

	Three Months Ended				Six Months Ended			
	June 28, 2008	June 30, 2007	Dollar Change	Percent Change	June 28, 2008	June 30, 2007	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total research and development expense	\$4,718	\$4,179	\$539	12.9%	\$8,691	\$8,335	\$356	4.3%

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As a percentage of  
total revenue

7.0%

8.9%

7.0%

9.6%

Research and development expenses increased by \$0.5 million, or 12.9%, to \$4.7 million (7.0% of revenue) in the three months ended June 28, 2008, from \$4.2 million (8.9% of revenue) for the three months ended June 29, 2007. The increase in research and development expenses is primarily due to an increase in compensation and employee related costs offset slightly by a decrease in material costs associated with internal research and development projects.



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Research and development expenses increased by \$0.4 million, or 4.3%, to \$8.7 million (7.0% of revenue) in the six months ended June 28, 2008, from \$8.3 million (9.6% of revenue) for the six months ended June 30, 2007. The increase in research and development expenses is primarily due to an increase in compensation and employee related costs offset by a decrease in material costs associated with internal research and development projects.

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.

Overall research and development headcount was 106 at both June 28, 2008 and June 30, 2007.

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 six months ended June 28, 2008, these expenses amounted to \$6.4 million and \$12.1 million compared to \$4.6 million and \$9.4 million for the three and six months ended June 30, 2007, respectively. In accordance with generally accepted accounting principles, these expenses have been classified as cost of revenue rather than research and development expense.

Headcount for research and development under funded development arrangements increased to 64 at June 28, 2008 compared to 61 at June 30, 2007, an increase of three employees or 5%.

*Selling and Marketing*

	Three Months Ended				Six Months Ended			
	June 28, 2008	June 30, 2007	Dollar Change	Percent Change	June 28, 2008	June 30, 2007	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total selling and marketing expense	\$13,471	\$10,944	\$2,527	23.1%	\$24,929	\$18,993	\$5,936	31.3%
As a percentage of total revenue	20.1%	23.3%			20.0%	22.0%		

Selling and marketing expenses increased by \$2.5 million, or 23.1%, to \$13.5 million (20.1% of revenue) in the three months ended June 28, 2008 from \$10.9 million (23.3% of revenue) in the three months ended June 30, 2007. The increase was primarily driven by increases in our home robots division of \$0.5 million in television, online and print media, and \$0.9 million in direct fulfillment related expenses. Our government and industrial division had increases of \$0.6 million in labor and other costs associated with bid and proposal activity as compared to the three months ended June 30, 2007.

Selling and marketing expenses increased by \$5.9 million, or 31.3%, to \$24.9 million (20.0% of revenue) in the six months ended June 28, 2008 from \$19.0 million (22.0% of revenue) in the six months ended June 30, 2007. The increase was primarily driven by increases in our home robots division of \$1.3 million in television, online and print media, \$0.6 million in marketing consulting and research and \$1.9 million in direct fulfillment related expenses due primarily to a 23.7% growth in our direct business, which carries a higher selling and marketing cost per revenue dollar than retail sales. Our government and industrial division had increases of \$0.8 million in labor and other costs associated with bid and proposal activity as compared to the six months ended June 30, 2007.

Overall selling and marketing headcount increased to 44 at June 28, 2008 compared to 34 as of June 30, 2007, an increase of ten employees or 29% growth, primarily due to headcount growth in our overseas territories.

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

	<b>Three Months Ended</b>				<b>Six Months Ended</b>			
	<b>June 28, 2008</b>	<b>June 30, 2007</b>	<b>Dollar Change</b>	<b>Percent Change</b>	<b>June 28, 2008</b>	<b>June 30, 2007</b>	<b>Dollar Change</b>	<b>Percent Change</b>
	<b>(Dollars in thousands)</b>				<b>(Dollars in thousands)</b>			
Total general and administrative expense	\$7,340	\$5,752	\$1,588	27.6%	\$14,118	\$11,079	\$3,039	27.4%
As a percentage of total revenue	10.9%	12.2%			11.4%	12.8%		

General and administrative expenses increased by \$1.6 million, or 27.6%, to \$7.3 million (10.9% of revenue) in the three months ended June 28, 2008 from \$5.8 million (12.2% of revenue) in the three months ended June 30, 2007. The increase in general and administrative expenses was driven by increases of \$0.8 million in compensation expense due to increased headcount, \$0.2 million in stock-based compensation, \$0.3 million in occupancy and depreciation expense and \$0.3 million in various other expenses, over the comparable period last year.

General and administrative expenses increased by \$3.0 million, or 27.4%, to \$14.1 million (11.4% of revenue) in the six months ended June 28, 2008 from \$11.1 million (12.8% of revenue) in the six months ended June 30, 2007. The increase in general and administrative expenses was driven by increases of \$1.4 million in compensation expense due to increased headcount, \$0.5 million in stock-based compensation, \$0.4 million in occupancy and depreciation expense, \$0.3 million in bad debt expense associated with collectability concerns of receivables due from Linens N Things given their financial condition and bankruptcy filing, and \$0.5 million in various other expenses, over the comparable period last year.

Overall general and administrative headcount increased to 106 at June 28, 2008 compared to 82 as of June 30, 2007, an increase of 24 employees or 29% growth.

For the full fiscal year 2008, we expect total operating expenses consisting of Research and Development, Selling and Marketing, and General and Administrative to be approximately 31% to 33% of revenue.

*Other Income, Net*

	<b>Three Months Ended</b>				<b>Six Months Ended</b>			
	<b>June 28, 2008</b>	<b>June 30, 2007</b>	<b>Dollar Change</b>	<b>Percent Change</b>	<b>June 28, 2008</b>	<b>June 30, 2007</b>	<b>Dollar Change</b>	<b>Percent Change</b>
	<b>(Dollars in thousands)</b>				<b>(Dollars in thousands)</b>			
Total other income (expense), net	\$242	\$887	\$(645)	(72.7%)	\$737	\$1,818	\$(1,081)	(59.5%)
As a percentage of total revenue	0.4%	1.9%			0.6%	2.1%		

Other income, net amounted to \$0.2 million for the three months ended June 28, 2008 compared to \$0.9 million for the three months ended June 30, 2007. Other income, net was directly related to interest income resulting from the investment in auction rate securities and money market accounts. The lower other income, net for the three month period ended June 28, 2008 as compared to the three month period ended June 30, 2007 is attributable to lower average auction rate securities and money market account balances and reduced interest rates earned on the portfolio.

Other income, net amounted to \$0.7 million for the six months ended June 28, 2008 compared to \$1.8 million for the six months ended June 30, 2007. Other income, net was directly related to interest income resulting from the investment in auction rate securities and money market accounts. The lower other income, net for the six month period ended June 28, 2008 as compared to the six month period ended June 30, 2007 is attributable to lower average auction rate securities and money market account balances and reduced interest rates earned on the portfolio.



**Table of Contents***Income Tax Provision*

	Three Months Ended				Six Months Ended			
	June 28, 2008	June 30, 2007	Dollar Change	Percent Change	June 28, 2008	June 30, 2007	Dollar Change	Percent Change
	(Dollars in thousands)				(Dollars in thousands)			
Total income tax provision (benefit)	\$ (4,306)	\$ 12	\$ (4,318)	N/A	\$ (6,655)	\$ 29	\$ (6,684)	N/A
As a percentage of total revenue	(6.4%)	0.1%			(5.4%)	0.1%		

In the three months ended June 28, 2008, we recorded a \$4.3 million tax benefit based on a projected effective 2008 income tax rate of 43.9%. Our tax benefit for the six month period ended June 28, 2008 was \$6.7 million based on our estimated effective 2008 income tax rate of 43.9%

**Liquidity and Capital Resources**

At June 28, 2008, our principal sources of liquidity were cash and cash equivalents totaling \$14.8 million, short-term investments of \$1.2 million and accounts receivable of \$24.3 million.

As of June 28, 2008, we held auction rate securities with a par value of approximately \$17.5 million and a fair value of approximately \$14.8 million. The fair values of these securities are estimated utilizing a discounted cash flow model which also considered limited secondary market indicators as of June 28, 2008. These analyses consider, among other things, the collateralization underlying the security investments, the creditworthiness of the counterparty, and the timing of expected future cash flows. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by us. As a result of the temporary declines in fair value for our auction rate securities, which we attribute to liquidity issues of the securities rather than credit issues, we have recorded an unrealized loss of \$2.7 million to Accumulated other comprehensive loss on the balance sheet. A substantial majority of the underlying assets of these auction rate securities are student loans which are backed by the federal government under the Federal Family Education L