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TASR - Q1 2018 Axon Enterprise Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q1 2018 Axon Enterprise, Inc. Earnings Conference Call. (Operator Instructions)

I would now like to introduce your host for today's conference, Mr. Luke Larson, President of Axon. Sir, you may begin.

Luke S. Larson - *Axon Enterprise, Inc. - President*

Thanks. Good afternoon to everyone. I'm Luke Larson, the President of Axon. Welcome to Axon's First Quarter 2018 Earnings Conference Call. Joining today are CEO and Founder, Rick Smith; and CFO, Jawad Ahsan.

Before we get started, Andrea James, our V.P. of Investor Relations, will read the safe harbor statement.

Andrea Susan James - *Axon Enterprise, Inc. - VP of IR*

Good afternoon. This call is being broadcast on the internet and is available on the Investor Relations section of the Axon Enterprise website. During our call, we'll be making references to our reported results, which you can find by reading our quarterly shareholder letter and the supplemental materials, both of which are available at investor.axon.com and on the SEC website. We'll start today with prepared remarks, and then we'll move to a live question-and-answer session.

Statements made on today's call will include forward-looking statements, including statements regarding our expectations, beliefs, intentions or strategies regarding the future, including statements around projected spending. We intend that such forward-looking statements be subject to the safe harbor provided by the Private Securities Litigation Reform Act of 1995. This forward-looking information is based upon current information and expectations regarding Axon Enterprise. These estimates and statements speak only as of the date on which they are made, which is today, are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. All forward-looking statements that are made on today's call are subject to risks and uncertainties that could cause our actual results to differ materially. These risks

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are discussed in greater detail in our annual report on the Form 10-K and our quarterly reports on the Form 10-Q under the caption Risk Factors. You may find these filings as well as our other SEC filings at investor.axon.com or at sec.gov by searching for filings under the Axon ticker, AAXN.

Okay, turning the call over to Rick.

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

Thanks, Andrea. Welcome, everyone. First and foremost, I want to commend our employees throughout the organization for helping us achieve outstanding first quarter performance. Our results reflect strength across the board, in our Weapons and Software & Sensors, domestically and internationally. The team has been working really hard to execute, and they deserve a lot of praise.

In Q1, we delivered record revenue and solid gross margins while continuing to execute against our cost control initiatives. This drove first quarter GAAP earnings per share of \$0.24.

We're incredibly excited about the opportunity in front of us and continue to position the business to deliver growth and increase shareholder value. The strategic tuck-in acquisition of VIEVU we announced last week is a great example of this. The deal adds a solid team that shares our mission of saving lives.

Our new holster partner, Safariland, produces high-quality products and, most importantly, has history and credibility with the law enforcement community. Those of you who aren't in law enforcement might not notice, but Safariland is a very well-regarded holster supplier and has a lot of fans in law enforcement, and it's very exciting to work with them in developing a holster for the next generation of TASER weapons.

Also, VIEVU technology is used by hundreds of police agencies and the acquisition adds 5 major U.S. cities to our customer portfolio.

Internationally, the acquisition adds Mexico City and Mexico's federal police. We believe this deal is great for customers because Axon has made an outsized investment in software, which will give these customers access to new features sooner than they otherwise would have had.

Also, serendipitously, VIEVU is based in Seattle and so we plan on integrating that team into our existing Seattle office.

This next part is really important, especially for the employees who are listening. This acquisition does not mean we get to rest on our laurels. The public safety video and digital evidence management space remains crowded and highly competitive, and our customers have dozens of vendors to choose from. We compete with large, well-funded and highly respected companies, including Motorola, Panasonic, L3 and more.

We believe we make the best solutions and we believe our solutions scale the best, but we need to keep innovating so that we can remain competitive and deliver the best solutions that our customers expect from us. We're continuing to expand Axon's footprint and gain momentum within our 4 primary growth engines. Bookings remain strong. Our product pipeline is robust with innovation at the forefront of everything we do, largely driven by input and feedback with our law enforcement partners. And as you saw in our shareholder letter today, we're taking up our top line guidance to reflect the strong start to the year as well as the addition of VIEVU.

I'm also proud to note that the organization has fully embraced our not-so-new mantra of "be scrappy" so you can expect to see us continue to be conservative on costs going forward.

Jawad will talk more about our guidance in a few minutes, but first, I'll turn it over to Luke to update you on product, execution and the integration of VIEVU. Broadly speaking, I'm thrilled with how our teams are performing and how the business is becoming increasingly dynamic to ensure that Axon remains at the forefront of industry change and writes the future of law enforcement.

Now over to Luke.



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Luke S. Larson - Axon Enterprise, Inc. - President

Thanks, Rick. We're moving pretty fast at Axon, and it's an exciting time to be part of the company that is executing on such a large and important mission.

We've come a long way since 2010, when Axon's stock was trading at just under \$4 per share and we were under a lot of pressure to exit the body camera business, and instead of exiting, we doubled down on body cameras and more importantly the software ecosystem, Evidence.com. One particular moment I'd like to call out is at a company meeting about 5 years ago when we did a survey, and 90% of the company wanted to exit the Axon business, and Rick Smith showed a picture of General Patton from World War II with a quote that said, "The road home goes through Berlin."

I call that out because this has been a big investment cycle, and I want to thank the investors that have supported Rick and Axon's vision. We are realizing the benefits of those investments today, and at the same time, we are investing for the next stage of growth. We're all working very hard to accelerate the speed at which we bring the leading public safety technology to police forces around the globe. We want to equip every officer with a body camera, a TASER and a seat on the Axon network.

You have the shareholder letter in front of you that does the heavy lifting, talking about many of the ways we are executing. I'll pull back the curtain a little bit more and then turn over the call to Jawad.

Over the next few quarters, there are 3 execution items that are most relevant to the investment community. The first and newest is the successful integration of VIEVU into Axon. I've appointed Bryan Wheeler, a Vice President of Software Engineering, to lead that integration. Bryan is a VP up in our Seattle office. He built our -- out our record management system and computer-aided dispatch teams while bringing those programs to life and also made significant contributions to our Digital Evidence Management road map. Bryan now reports directly to me, and he's been doing a fantastic job leading the integration so far. Bryan brings a ton of energy, focus and technical product knowledge and a deep understanding of how our business runs today, which will be essential for making the integration a success.

Our goal is to eventually convert every VIEVU customer to the Axon network, but initially, we will deliver upon VIEVU's contracts while it operates as a subsidiary within Axon. We've already notified those customers that Axon is committed to their body-worn camera programs, and the customer feedback has been positive.

The second area of importance is on moving the Software & Sensors segment to profitability, which means continuing our existing momentum with body cameras and software and expanding and scaling Axon Fleet. We've set a goal to be the market leader in in-car video.

Our third area of focus is the development of our Axon Records product, which is still pre-revenue but remains key to our long-term vision of using technology to automate boring and tedious police report-writing. We want to put officers back out on the streets, doing what they do best and getting to know their communities and keeping them safe. We are on track for a successful launch of Axon Records in 2019.

I want to end with a quick update on International. Our focus on Tier 1 markets is really paying off. Our Chief Revenue Officer, Josh Isner, has built a fantastic team that is organized with 3 managing directors for EMEA, APAC and the Americas. Two of our largest video booking deals in the history of the company came in, in Q1: Kent and Essex from the U.K. and Victoria Police from Australia.

I spent a week in Europe at the end of March and was very impressed with several items. First, our relationship with key leaders in the U.K. is great. And we are -- we now have incoming requests and interest from agencies to broaden their TASER deployments as well as interest in our entire Axon product suite.

At the end of March, in the U.K., Simon Chesterman, the lead for the National Police Chiefs' Council, stated every frontline officer should carry a TASER, a massive shift in thinking from the historical view where only about 10% of frontline officers in the U.K. carry TASERs today.

I also visited Germany and Italy and was very impressed with our country managers in both of these markets. We have several large agencies in both Germany and Italy that have not previously been in our pipeline that are trialing our full Axon suite and TASER product line. Over 2 years ago,

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the Italian parliament legalized TASER, much to the work of Rick's international trip, but the devices were subject to further scientific testing and successful field trials.

I'm proud to announce that, on March 20, the Italian Ministry of the Interior approved 6 large police forces in Italy to start the trials. One other highlight from the trip was we met with the Pope's private security detail that carries TASER. I thought it was pretty awesome that the Pope is protected by TASER.

In summary, I'm very pleased about our progress in international, and now will turn over the call to our CFO, Jawad.

Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

Thanks, Luke. We're pleased to report another strong quarter of execution. Record revenue, strong gross margins and good cost control enabled us to bring \$0.24 to the bottom line.

I'm going to first talk about the VIEVU acquisition, then I'll unpack the guidance for you. After that, I'll touch upon a few housekeeping items, and then we'll go right to Q&A.

So first, the VIEVU acquisition. As you can see in our shareholder letter, we paid \$7.1 million upfront in cash and stock, with contingent consideration in the form of a stock-based earn-out over the next 2 years. This is a great deal for Axon shareholders and most importantly for the customers, who can now access the Axon network and the software features we're investing in.

This deal turns a competitor into a partner and supplier and is synergistic for both companies. We only recently closed on the deal and are still working to quantify the extent of these synergies, but expect there to be significant opportunities to rationalize expenses by eliminating duplicate sales efforts and combining certain aspects of our teams, both of which are based in Seattle.

I am particularly excited that this deal gives us 5 U.S. major city customers at about a 20% lower customer acquisition cost than we'd normally realize organically. Many people on both sides worked hard to get this deal done, and we're very pleased with the result.

Next, I'd like to unpack our guidance and how we're thinking about the full year. We're raising our revenue guidance by 2 percentage points, which reflects both the strength of Q1 and the VIEVU acquisition. In Q1, we had very strong international Weapons revenue, which we do not expect to benefit from in Q2. We expect Q2 weapons revenue to grow about 7% to 10% year-over-year. So as you think about the timing of how revenue will flow through the P&L and you rebalance your estimates for the full year, we expect Q2 revenue to be down sequentially from Q1.

Turning to operating margin guidance. We did a great job on costs in Q1, and as Rick said, our new culture around driving leverage is here to stay. We were pleased to deliver a 13% operating margin in Q1, but we're still investing for growth and we have more investments to make this year.

As you think about VIEVU's impact on operating margins, it's really in 2 buckets. First, some of VIEVU's larger contracts were priced at a level below what Axon would've bid, and we are going to honor those customer contracts. As a result, we'll see some gross margin pressure in the Software & Sensors segment as we deliver on those contracts. Second, we expect some nonrecurring transaction and integration expenses. What we feel great about is that, thanks to our rigorous cost control, we can absorb those contracts and still maintain our 2018 guidance for operating margin expansion.

To be clear, this implies an operating margin of 6.8% to 7.8% excluding onetime transaction costs, consistent with what we told you in February. Onetime transaction integration costs should amount to about 50 basis points of margin for the full year, with the majority hitting in Q2.

So as we look at the balance of the year, we expect Q2 to be the low point in operating margin and build from there. This reflects an expected increase in OpEx in the second quarter, driven by focused investments we're making in our new product pipeline, VIEVU operating expenses and onetime acquisition costs.



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Also, because we don't want there to be any surprises, our guidance commentary excludes the impact from stock-based compensation associated with Rick Smith's new 10-year, no-salary, equity-based compensation plan. Our shareholders will vote on that plan on May 24, and the board and myself recommend they vote for that plan. We think it's a great plan for Axon and for shareholders. Rick hasn't gotten a paycheck in the past few months, and he won't get one for another 10 years. Under this plan, Rick will only get paid if we deliver outsized growth in revenue and EBITDA and corresponding shareholder returns.

We expect to incur some noncash expenses associated with Rick's stock plan, and the amount will be determined by the stock price at the time of the vote. We'll make sure to give visibility around that on our next earnings call, and as a reminder, our non-GAAP earnings now exclude stock-based compensation expenses, so adjusted EPS won't be affected.

To wrap up our margin commentary, even with absorbing VIEVU's contracts and operating costs, we're still on track to hit our operating margin guidance for the full year.

Next, I want to address the portion of our shareholder letter that talks about TASER Weapons growth. We've historically talked about TASER Weapons having 4 primary growth drivers. Those are: selling more to domestic law enforcement, expanding internationally, shortening upgrade cycles from 8 to 5 years and offering more features and smarter weapons. We still have a long runway in law enforcement, but we're also seeing increased demand for the TASER weapon outside of law enforcement.

We're getting orders from private security, campus security, U.S. federal agencies and several others. We broke that down for you in our shareholder letter. This is not a disclosure that we intend to make going forward. We don't plan to keep breaking out TASER Weapons sales by geography and customer segment, but we did want to communicate the source of our confidence in a growing TAM which is helping to drive strength in that segment.

Finally, some housekeeping items for those of you who've followed us for a while. We're updating several of our descriptors in the Software & Sensors segment. There are 3 minor changes. The first change is that we are now giving Software & Sensors backlog rather than future contracted revenue, so that our metrics are more closely aligned with the backlog numbers we report in our 10-Q.

As of March 31, 2018, we had approximately \$570 million of Software & Sensors backlog, which is a slightly different calculation than the former future contracted revenue, though the numbers were pretty similar. The backlog figure includes both recognized contract liabilities as well as amounts that will be invoiced and recognized in future periods. The second change is that we will now be referring to annual recurring service revenue as Software & Sensors annual recurring revenue, and that includes cloud-based software, data storage and warranty, same as above. The third change has to do with how we report our Software & Services revenue. Same as always, product roughly aligns with hardware revenue and service aligns with cloud-based software revenue. And so starting this quarter, we've begun referring to Software & Sensors service revenue as Axon Cloud revenue, which is a better descriptor because that revenue bucket includes all the items tied to our cloud-based software platform, Evidence.com, and the professional services and data storage that support our cloud-based software offering.

Mirroring that, when we talk about the product bucket, we'll be calling that Sensors and Other, because it encapsulates revenue related to our on-officer body cameras, Axon Fleet hardware, Signal Sidearm, TASER Cams and other hardware plus warranty revenues. What this does is isolate our Axon Cloud revenue so that the investment community can track this growing and increasingly important category.

And with that, operator, we'd like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Mark Strouse from JPMorgan.



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Mark Wesley Strouse - *JP Morgan Chase & Co, Research Division - Alternative Energy and Applied & Emerging Technologies Analyst*

Yes, so my first question's for Jawad. I'm sorry if I missed this in the prepared remarks, but I'm just trying to kind of back into what the organic guidance is for the year. Did that change? Or is everything just because of VIEVU?

Jawad A. Ahsan - *Axon Enterprise, Inc. - CFO*

No. The organic guidance for the year, we're sticking to 300 to 400 basis points of improvement. (inaudible)

Mark Wesley Strouse - *JP Morgan Chase & Co, Research Division - Alternative Energy and Applied & Emerging Technologies Analyst*

Okay. But it sounded like though -- right. It sounded though that it -- maybe my impression was that you had a good start to the year and you got these lower-margin VIEVU contracts coming on. So is it fair to assume that the organic operating margin might have been a bit stronger, if it hadn't been for this acquisition?

Jawad A. Ahsan - *Axon Enterprise, Inc. - CFO*

That's correct.

Mark Wesley Strouse - *JP Morgan Chase & Co, Research Division - Alternative Energy and Applied & Emerging Technologies Analyst*

Okay, okay. And then, Rick, I know it's still early, but with VIEVU, can you share any kind of initial feedback that you've gotten from VIEVU's customers? And technically speaking, is there any kind of a change-of-control clause or anything in those contracts that could be a potential risk?

Patrick W. Smith - *Axon Enterprise, Inc. - Co-Founder, CEO & Director*

Yes. So we've reviewed the contracts. There's no legal risk from a change-of-control provision. And I would say, generally, the feedback from customers has been positive, in that some of them, their procurement ended up going to VIEVU largely for price. And so some of the commentary I've heard back is that they're actually rather excited that they're now getting on to the Axon platform and that we're going to honor those contracts. So we intend to make this a very positive experience for every one of those customers.

Operator

And our next question comes from the line of Steve Dyer from Craig-Hallum.

Steven Lee Dyer - *Craig-Hallum Capital Group LLC, Research Division - Managing Partner & Senior Research Analyst*

Just following up on Mark's question around organic, how the organic growth is tweaked in the guidance. On the revenue side, sort of the new revenue guidance would sort of imply that Q1 was flowed through, and maybe not a lot was added or expected for VIEVU. I just wondered if you're willing to sort of break out, ballpark, what you're sort of anticipating from VIEVU over the balance of the year versus what was already in the numbers.



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Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

Yes, so we took up our revenue guidance, as you pointed out, Steve, and we were, as Mark pointed out, on track to exceed our initial guidance. And the operating expenses in VIEVU, that business is dilutive to our Software & Sensors business. And so what we feel comfortable is that we're going to be able to absorb that and stick to the original guidance we gave around operating margins.

Steven Lee Dyer - Craig-Hallum Capital Group LLC, Research Division - Managing Partner & Senior Research Analyst

Yes. I'm talking, I guess, revenue. If, very rough numbers, you'd be by about \$10 million in the revenue line this quarter, and the raise on the revenue line would sort of imply about that kind of an uptick. So just wondering if maybe the last 3 quarters of the year organically were a little softer given the big first quarter, or if there's just not a lot of VIEVU revenue you're assuming.

Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

Well, we don't expect generally VIEVU to be all that material for the year. We did, as you mentioned, have some onetime items in Q1 [earned] from the international Weapons segment that we don't expect to recur.

Steven Lee Dyer - Craig-Hallum Capital Group LLC, Research Division - Managing Partner & Senior Research Analyst

Got it. Okay. And so I guess, along those lines, Weapons grew by 10% in the first quarter, and I think you had said 7% to 10% for the second quarter. Are you seeing sort of, I guess, a broader downtick in growth? Or is that sort of a -- I guess, a sequential anomaly? I'm trying to figure out if -- at some point, if TASER 60 has gone on long enough to where, potentially, you just see an organic slowdown a little bit.

Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

Yes, great question. We're still seeing our Weapons business grow lower double digits organically. What you're seeing is really the sequential anomaly.

Steven Lee Dyer - Craig-Hallum Capital Group LLC, Research Division - Managing Partner & Senior Research Analyst

Got it. Okay. And then, I guess, lastly for me, staying with Weapons. The operating margin there ticked below 30% this quarter. Historically, that used to be sort of a mid- to high-30% operating margin business. I'm just wondering if mix has suddenly shifted there a little bit over time, or maybe what I'm missing, if there's more R&D expensed for new products or what have you.

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

Yes, so this is Rick. I would say, I think the majority of what you're seeing there is we're seeing more and more of the TASER deals are going in as part of the Officer Safety Plan, OSP. And so when you bundle the TASER Weapons together with cameras and software, some of it is just a little bit of just revenue allocation, but some of the discount on -- like the Software & Sensors business tends to see more discounting than the TASER business, so on those bundled deals, by the time you end up with the revenue allocation, that ends up perhaps allocating some revenue away from the TASER hardware, which would obviously impact the margins.

Operator

And our next question comes from the line of Saliq Khan from Imperial Capital.



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Saliq Jamil Khan - Imperial Capital, LLC, Research Division - VP

Great. Rick, Luke and Jawad, guys, a couple of real quick questions on my end, the first one being is, if you take a look at the outlook, what is -- what are your thoughts on the percentage of the trial users that are becoming full-paying customers?

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

Got you. So let me take that one. The -- it's a little bit hard to give exact numbers, because in many cases, people have contacted us about the trials. We're in the midst of -- they might have already been procuring weapons, they may have gone into a field trial. I can tell you this, and I'm just going to look at Luke and Jawad, make sure you guys agree with this, of the major customers that moved into a trial, if they completed the trial, pretty well universally, we won the deal. I mean, we still have some of them where there's contracts -- those trials are still ongoing. But we're very happy that it was strategically a very successful project, in that we saw the vast majority of procurements moving towards trials, which is what we wanted to see, right? Put the stuff in the hands of the users, not in the hands of some bureaucratic purchasing committee, and let the users evaluate what does the job for them. And we've -- I think we've moved the ball materially in that direction, and when it moves that direction, we do really well. And of those deals that have closed, a very high percentage have gone our way. And I can't think of any that went away from us.

Luke S. Larson - Axon Enterprise, Inc. - President

Yes. Any time we see a trial of over 100 units, we have a very high success rate. I can't think of a deal we've ever lost where we have a 100-unit trial.

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

Well, we had one or two, and that's particularly if it went on-premise because of a, sort of an institutional belief within IT, where they said, "Hey, we're going to run this on-premise." And frankly, our assessment on that is that we believe the tides of history are kind of on our side here, that the world is moving towards an internet-enabled, connected cloud world, and so we believe we've got a very good shot to win those customers in the future.

Saliq Jamil Khan - Imperial Capital, LLC, Research Division - VP

(inaudible) what really kind of surprised me is you had Kanders that, for years, was talking about how great VIEVU, was and he had a real good market opportunity there. So what do you think motivated Kanders to sell Safariland's VIEVU over to you guys?

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

So yes, he's a very smart guy. I mean, it's a well-run company. We actually were talking about this internally, and to be honest, I was expecting the phone call. Because I remember, when we first launched into the software space many years ago, we were surprised at how expensive it turned out to be to build the team, to build the support infrastructure. To basically build the platform cost far more than we expected. Now in our case, we pressed through that because, ultimately, we saw the opportunity that we were the first mover and that we were creating the space, and we felt we could create a very valuable business. If I put myself in the Safariland position, basically realizing the importance of the software and the cost of doing it, it's hard to make the economics work when there's already a really strong market leader. So if I were in their position, I likely would have come to the same conclusion, that just the level of investment simply couldn't be justified, given that Axon already had such a strong lead in the marketplace. And I really respect that Safariland reached out to us, and ultimately, we found a way to leverage everybody's strengths and help them to continue to build a strong and growing business. And frankly, I'm delighted we can work with them now because they're really good at things around support gear and holstering that is going to make our solutions more valuable and allows them to focus on continuing to run where their core competencies are really strong.



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Saliq Jamil Khan - *Imperial Capital, LLC, Research Division - VP*

Well, I agree. I've just had a pretty nice switch over there into the marketplace. And just one last question, Rick. If you take a look at the product portfolio versus your -- and if you map one over the other, how do I start thinking about the margin potential opportunities that you have once the integration happens? And what could that product portfolio look like when you really tighten it up?

Patrick W. Smith - *Axon Enterprise, Inc. - Co-Founder, CEO & Director*

Yes. So I think part of what -- as the Safariland team looked at this, they would have had to spend a lot of time, energy and effort building a system to be competitive with what we had already built. So from just a global economics perspective, this is much more efficient for us to acquire VIEVU and be able to leverage what we've built. So I would say, over the next 6 to 12 months, the team is going to be -- the team at VIEVU is going to be really helping figure out how we integrate the best of what they've got into our platform, and then everybody can shift their focus to moving the ball further down the field, building new exciting features that are solving new problems for our customers. And at this point, there's -- it's really an exciting time to be at Axon because this, having the major cloud platform in public safety and running one of the largest datasets in the world, opens up just virtually unlimited opportunities for us to leverage that into additional capabilities and additional expansion opportunities. So for us, one of the challenges is making sure my partner Jawad here keeps us focused on sequencing those investments so that we're making the investments the right way to add maximum value for customers while also managing the company with some financial rigor.

Operator

And our next question comes from the line of Jeremy Hamblin from Dougherty & Company.

Jeremy Scott Hamblin - *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Consumer & Retail*

I wanted to jump into thinking about this kind of intermediate-term plan that you have on your Software & Sensors business on breakeven. You mentioned that -- overall to the Axon business that revenues may not be material. But I imagine, as it pertains to Software & Sensors, it is more material. Are you still on track to see that business break even, given the contracts that you've inherited, kind of in the next 3 years?

Luke S. Larson - *Axon Enterprise, Inc. - President*

Yes, I'll -- we're not making any changes to our long-term model. Every day, Jawad and I get up and think about how do we turn the Software & Sensors business into a profitable business, and we've got really good plans in place to execute on that plan.

Jeremy Scott Hamblin - *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Consumer & Retail*

Okay, great. And then I wanted to also ask, you had some great updates here on progress in Europe. And just thinking about the sales cycle that you saw play out in the U.K., maybe in Australia, how has the evolution of the length of the sales cycle played out in the U.K. where it is today, and how we might expect that to play out in some of these newer frontiers in Germany or Italy. Have we gone from a kind of 36-month sales cycle to now, in the U.K, we're at 12 to 18 months? Can you provide any color on that, Rick?

Patrick W. Smith - *Axon Enterprise, Inc. - Co-Founder, CEO & Director*

Yes, so I don't know that it has changed the sales cycle. We're just a few years into this sales cycle, where we're now seeing the approvals in Italy, we're seeing field trials happening in other continental European countries. I think there are some differences, where the U.K. and Australia still tend to have regional police units. So there's 44 constabularies in the U.K. and around 10 in Australia, whereas in Italy and France, for example,



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we're dealing with more major national police forces. So larger institutions tend to have longer decision cycle times. So I don't know that I've seen it changing, but we're a few years into it now, and I'm glad to see that we're starting to see some progress. Luke, do you have anything to add?

Luke S. Larson - Axon Enterprise, Inc. - President

Yes. I mean, I think, when we look across the table at our international customers, we've done a really good job building out a direct sales channel where we've hired local nationals. And we now, I think, are gaining access to key stakeholders that we just didn't have before. And this is isn't just in the last few months. This is really a culmination of 2 to 3 years of hard work. This last quarter was a record international quarter at \$23 million. Again, when I was over there at the end of March, they were preparing for Mayday events. Every major city in Europe has protests, and they're looking for effective use-of-force options to deescalate those types of situations. And so we're seeing all the right signs in markets like Germany and Italy in addition to expansions in the U.K. So we feel really good about our international progress.

Jeremy Scott Hamblin - Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Consumer & Retail

Yes. Just to expand on the question, or maybe clarify, the sales cycle that you have in the U.K., where you're now an established player, has that shortened? That's really the base of the question.

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

I think it'll likely shortened a bit. Yes, I think there's growing confidence versus when we were new in that business, in the body camera business, in the U.K. and the cloud was a brand-new concept when we first started, whereas now the largest agencies in the U.K. are customers. I think we're seeing more and more customers starting to convert over onto our platform. And the buzz between them is sort of validating that, this whole business model of using the cloud and internet-enabled docks is some real advantages. So I'd say that it's accelerating the decision cycles in the U.K.

Jeremy Scott Hamblin - Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Consumer & Retail

Okay, great. And then last one here is on the Axon Fleet. And just thinking about that business, you've really made very quick progress on gaining market share there. I wanted to understand, in terms of the reporting of that revenue and the way that you're selling that service, clearly disruptive to the current player and market structure. Is that going to be reported under software services revenues moving forward? Or how is that business going to be reported?

Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

Yes, it is under Software & Sensors, Jeremy. And at this point, we don't have any plans to break that out separately. At some point in the future, we may revisit that. But for the foreseeable future, we're going to include that in Software & Sensors.

Jeremy Scott Hamblin - Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Consumer & Retail

Okay. So but is that going to be included, right now, in net sales from products or net sales from services?

Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

Yes, it's actually both. So the software portion will be under Axon Cloud, as I said the new nomenclature for our software revenues, and then the hardware around Fleet will be under the Sensors and Other.

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Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

And by the way, I would add in there, we, last year, mentioned we had acquired a team in Finland. Juha and his team over there are just doing a fantastic job. I'm really excited at the vision of bringing, particularly around where the Fleet product line's going to evolve in the future. So we're -- I think that's one of the exciting areas of the business for me.

Operator

And our next question comes of the line of Glenn Mattson from Ladenburg.

Glenn George Mattson - Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research

Just a couple. On the acquisition, can you give us a sense of how much -- how many years are left on those contracts, for instance? Like take the NYPD. Was it a 3-year or 5-year deal at the time that they signed with VIEVU? And the reason I'm curious is just, like I know they were significantly underbidding you in a lot of situations, which you've mentioned. But how do you feel about the confidence of getting those contracts up to more standard -- your more standard pricing structure upon renewal?

Luke S. Larson - Axon Enterprise, Inc. - President

Yes, so at this time, we're not going to talk about any specific customers. But I would say, the way we're thinking about this is, there'll be a natural kind of upgrade cycle where those customers, the average life of the hardware's anywhere from 2.5 to 3 years, and we're going to go out and work with those customers and really earn their trust and show them the benefits of the Axon network. And we -- in early discussions with several key customers, we feel really good about their willingness to move over to the Axon network.

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

Yes, and I would add that, we're -- part of the value of building the Axon network is that it gives us the ability to offer future products and services that are extremely valuable. So I've already had some discussions with some of these customers where they're validating that these future products and services that we're building are going to be really valuable. So I don't think we have -- we're not thinking of those in terms of like how do we increase like the prices at some renewal in the future. We're thinking about this, how do we delight those customers with new services and new capabilities that are going to be really valuable for them that they'll want to purchase some of the new things we're building? And I'm very confident that we'll be able to earn the additional business with these customers over time.

Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

Yes. And actually, just to build on that, the proof point of what Rick just spoke about is that many of our contracts, even though they're on average 4.5 to 5 years in length, don't end up running their full term because we're introducing new products and new solutions at such a rapid pace, some of these contracts get rewritten in upsell situations. And we would expect the same to continue in the future.

Glenn George Mattson - Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research

Great, that's helpful. Jawad, how about service margins? They were up, I think, 10 percentage points sequentially and maybe 8 year-over-year. Is there anything going on there beyond just getting better scale, I guess?



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Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

So part of it was we've completed our migration costs from AWS to Azure. So there were some duplicate costs, there were migration costs in there. So some of that, we just benefited from having that complete and behind us. Jawad, do you have anything else to add?

Jawad A. Ahsan - Axon Enterprise, Inc. - CFO

That's exactly it, and also the fact that we continue to add users to the network, and we're getting scale there.

Glenn George Mattson - Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research

Great. And last thing, just curious on the -- seems like the TASER Cam and -- I mean, the dock ebbs and flows, I guess. Dock was kind of -- TASER -- the Dock was a little weaker maybe last quarter, so maybe there was some catch-up, but TASER Cam was oddly strong this quarter. Was that just a few random orders maybe in the international orders?

Luke S. Larson - Axon Enterprise, Inc. - President

Yes, we had a really, really strong international quarter. It was actually a record quarter, and we're still selling some TASER Cams internationally.

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

I can think of one major U.S. order as well. Probably -- our U.S. customers typically don't like us talking about them with specificity, but there was at least one that I know who went with TASER Cams that was pretty significant.

Operator

(Operator Instructions) And our next question comes from the line of Bill Baker from GARP Research.

William Wendell Baker - GARP Research & Securities Co. - Founder & President

My question is about artificial intelligence. I greatly appreciated your having some folks from that part of your business in the Analyst Day several months back. And just wanted to hear your thoughts about developing this internally, you've placed a lot of emphasis on that, and strategically how you're thinking about that. Because I see you passed on Avigilon, and a lot of my colleagues out here in The Street really were a little fearful of Motorola a year or 2 ago, and to see them do this deal, are you seeing this as a signal that there's a divergence in strategic thinking here among the 2 companies, and you're not going to be in that adjacent market? Or do you think internally you're going to be morphing beyond the straight police kind of applications over time?

Patrick W. Smith - Axon Enterprise, Inc. - Co-Founder, CEO & Director

Hopefully -- for sure. We're very focused on building our (inaudible) as a core asset. I would say there is a bit of a difference. Some of our competitors are growing through like a heavy acquisition approach. And [interestingly] I was talking with some of our technical leaders, and the risk of that is you end up acquiring a bunch of technical debt because you're buying a bunch of things that weren't necessarily designed to play well together. And doing that integration, it's really hard to buy a lot of different things and then end up with an Apple-esque user experience where things really work well together. So our approach is much more focused on building things in a highly integrated way. So from an AI perspective, we're not doing foundational AI research on the scale of like a Google or Facebook. Our team is really focused on leveraging the best-in-class AI tools and algorithms, and we're building the data models based on this wonderful -- we have a -- one of the largest datasets in the world at 22 petabytes and growing exponentially. Now that's our customers' data. We'll be very clear. It is not ours. But our customers can now opt in to be able to have



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that data used to train our AI algorithms. They can then automate many of the mundane and boring and tedious tasks that law enforcement has to do with this data and, ultimately, to unlock the value that's inside that data. So we believe having more data and a focused AI team allows us to build better features so we win more customers, which gets more data which we can feed to our team to build better features and so forth, and the flywheel continues. So we're feeling very confident about our approach. We do know that we're up against some people with deep pockets that are competing with us, and we're enjoying the competition. We feel really good that our strategy is one that, over the long haul -- I'm just saying -- let's just say we're confident in our approach, and we're excited to see how the future unfolds.

Operator

And our next question comes from the line of George Godfrey from CL King.

George James Godfrey - *CL King & Associates, Inc., Research Division - Senior VP & Senior Research Analyst*

I just wanted to start with VIEVU. From -- Rick, from the comments, it wasn't clear to me whether you were leaving the customers on VIEVU hardware and then moving them over to Evidence.com or do you plan to migrate them to the full Axon solution immediately. How does -- and what is the time frame for moving the existing customers to your solution?

Patrick W. Smith - *Axon Enterprise, Inc. - Co-Founder, CEO & Director*

Yes, those are issues that we're working through right now in consultation with our customers. So we don't -- we don't have a firm time line on that. So that's going to be determined, again, in close consultation with our customers to make sure that they have input on the path that we choose forward.

George James Godfrey - *CL King & Associates, Inc., Research Division - Senior VP & Senior Research Analyst*

Got it. And then, secondly, New York City and Boston, I think, are 2 Northeast cities that have been really slow to adopt the body camera solution. Given that New York signed a contract for 5,000 cameras with VIEVU, has their thinking around that changed? Have you been able to ascertain that?

Patrick W. Smith - *Axon Enterprise, Inc. - Co-Founder, CEO & Director*

So the biggest agencies in particular have asked us not to comment or hypothecate (sic) [hypothesize] about what their plans are, although I do know that the mayor of New York has made public statements earlier this year about accelerating the cameras to full deployment. And if you -- we'll have our IR team send you references to some of those statements, but we will be really careful not to speak on behalf of our customers.

Operator

And at this time, I'm showing no further questions. I'd like to turn the call back over to Rick for any closing remarks.

Patrick W. Smith - *Axon Enterprise, Inc. - Co-Founder, CEO & Director*

Okay. Well, hey, everybody. It's hard not to smile when you see the fruits of the labor and the hard work that all of our people have done over the past few quarters to just pitch in on a quarter like this one. So thanks for sticking with us, and we're really excited to have you all come out to our shareholder meeting and tune in for our calls in the rest of the year.



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Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.

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