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TASR - Q2 2018 Axon Enterprise Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2018 Axon Enterprise, Inc. Earnings Conference Call. (Operator Instructions) Also, as a reminder, this conference call is being recorded.

At this time, I'd like to turn the call over to your host to Luke Larson, President of Axon. Please go ahead, sir.

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

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

Before we get started, Andrea James, our VP 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 the call, we'll be making references to our reported results, which you can find by reading our quarterly shareholder letter, which is available at investor.axon.com and on the SEC website. We'll start with short prepared remarks, and then we'll take questions.

Statements made on today's call will include forward-looking statements, including statements regarding our expectations, beliefs, intentions or strategies regarding our future, including statements around projected spending. We intend that such forward-looking statements be subject to

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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, 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 are discussed in greater detail on our annual reports on the Form 10-K and the quarterly 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 sec.gov and searching for our filings under the AAXN ticker.

Okay. Now turning the call over to Axon's CEO, Rick Smith.

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

Thanks, Andrea, and welcome, everyone.

We're pleased with our second quarter results and feel great about the way our teams are blocking and tackling as we execute against the goals we outlined. One of the big accomplishments in the quarter was our follow-on offering, which we consider a re-IPO. The offering was highly beneficial on a couple of key fronts. First, it provided us with significant resources to be able to accelerate our shift across the entire business towards subscription. And we've begun executing on the internal functions now to support that so we can move the TASER business even more aggressively to subscription.

We'll note that subscription as a percentage of orders did drop in Q2, which was partly a result of mix. We had some international and distributor orders that skewed the percentage. But also as a result the fact that we were not yet pulling every lever to drive subscription sales partly because of resourcing. We now have the flexibility to accelerate our plans. So please stay tuned for some exciting times as we transition the business model more aggressively.

As I mentioned earlier, we view Axon as having re-IPO as a software and technology company rather than as a weapons hardware manufacturer. It makes sense for us to reintroduce ourselves to the capital markets in a way that more accurately reflects what Axon is rather than what TASER was. The TASER weapon obviously remains a huge and important part of our business. But even the weapon itself, we believe, has the ability to benefit from the strong network effects that we filled into our software platform. There are so many opportunities for us to make the TASER systems more connected and more integrated into the larger Axon network.

It's not easy to transition from a hardware company to a SaaS software plus hardware solutions company. And we are incredibly excited to be making this happen. And as CEO, I just want to thank our shareholders for responding well, and thanks to all of you who've been so supportive of this transition over the years. And I've allocated the capital that will allow us to continue to execute and return value back to you.

Moving now to some of our new initiatives. We're now entering the testing and refinement phase of Axon Records, which is a pretty exciting place to be. An early version of the product is in field testing with customers. I also want to highlight the new partnerships with DJI and Milestone. This is interesting to note because it shows that we're really extending the network beyond the hardware that we manufacture and having world-class partners and third parties that can begin to come to light on the Axon network.

We now have 30 petabytes of data. The sheer amount of data that we are hosting in our secured cloud is continuing to grow, and customers are continuing to find great value in the goods and the services that we're selling.

We also held our annual user conference, Axon Accelerate, in June. And we were overwhelmed by the positive response from the industry. We've had over 1,300 police security, legal and technology professionals in attendance, which included both members of the Axon network and noncustomers, putting Axon and our Accelerate Conference at the center of thought leadership and public safety.

And with that, I'll now hand off to Luke to go deeper into our operations.

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

Thanks, Rick. At Axon, we want every police officer in the world to carry a TASER, wear an Axon camera and every public safety official to have a seat on the Axon network. Every day, we are executing against that mission. Every thing we do comes back to our mission of making the bullet obsolete and enabling truth and fairness in our justice system.

I want to start off by talking about our VIEVU integration, which is an important area of execution for us. As you know, we acquired VIEVU in May, which was a key body camera competitor. Because we are building customer synergies across the Axon network, the addition of several new law enforcement agency customers both enhances the value for our existing customers as well as the ones who are joining because they can more easily share data with each other across the public safety and justice system information chain. Those customers can take advantage of our scale, and they are pleased to be working with Axon.

We also continue to be very impressed with the VIEVU team that joined us in Seattle. We inherited a group of solid people and it expanded our capabilities, so we feel like we acquired more than just customers and products. We added a team that makes us better and stronger.

Also, I want to mention one more item related to VIEVU. In June, we received a letter from the Federal Trade Commission notifying us that they are looking into the acquisition to ensure that the marketplace remains competitive. We view this as a routine matter, and you'll see some language around it in our upcoming 10-Q filing later this week. We'll keep you posted on any developments, but we are cooperating fully with the FTC and are confident that the acquisition was a benefit to customers and that the FTC will recognize this.

We are highly focused on customer satisfaction, and our customers continue to validate our approach. You see that in our financial performance and also new customers sign-ups. In July, Honolulu became the 45th major city customer to join the Axon network. And at the end of June, we now have over 300,000 booked seats on the Axon network. That represents a more than tenfold increase in user accounts since the first half of 2015. We have 10x our Evidence.com subscriptions in about 3 years. And with the total addressable market of more than 2 million users, there's still a great runway ahead of us.

Now I'll turn the call over to our CFO, Jawad.

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

Great. Thanks, Luke. Our Q2 results reflect another quarter of solid execution and strong operating performance. There are a few things I want to touch upon, and then we'll leave plenty of time for questions.

As Rick said, the follow-on offering was a success and puts us in a strong financial position for our next stage of growth. We want to transition the majority of our cash flow to subscription pricing models. The cash flow from selling TASER Weapons funded 2 prongs, growth and investment strategy. First, it allows us to invest in products that address our existing market such as body and in-car cameras in evidence management. Second, it allows us to invest in products that will expand our market reach such as records, dispatch and drones. These investments will come in the form of people, programs, systems and potentially acquisitions. We now have a balance sheet that gives us the financial strength and flexibility to execute aggressively on the strategy.

Second, you heard from Luke about our progress with the VIEVU integration. From a cost perspective, as we expected, the majority of integration costs hit in the second quarter, and we expect about 100 basis points of adjusted EBITDA margin impact to the full year. As we said last quarter, our strict expense controls are allowing us to absorb the gross margin pressure on some of the VIEVU contracts while maintaining our earnings guidance for 2018.

As you can see, the leverage in our business model continued to be evident in Q2. Revenue grew 25%, and adjusted net income more than doubled. We feel great about the leverage we've been demonstrating in the first half. Looking at the back half of the year, you can expect to see us invest

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more heavily in some of our key growth areas, including adding engineers to Axon Records and Dispatch while continuing to generate strong earnings growth. And that's reflected in the guidance we're providing today.

You'll notice that we're guiding to a full year adjusted EBITDA margins of 14% to 16%. To be clear, this represents the same level of expense control that we talked about in prior quarters, but given the unpredictable stock compensation adjustments related to Rick's new compensation plan and the onetime acquisition costs related to VIEVU, we're moving over to an existing metric that is clear and works better for period-over-period comparisons.

Thank you all for dialing in today. And with that, I'll turn it back to Andrea.

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

Thanks, Jawad. Before we go to questions, I have one housekeeping item for you guys. Instead of being scrappy, next quarter, we're going to ask the majority of listeners to please listen via webcast, and we'll save the conference call line for those of you who wish to ask questions.

Okay, Dylan, let's go to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Steve Dyer from Craig-Hallum.

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

Just a couple quick ones for me. On the software and services side of the business, you'd indicated ARPU down quarter-over-quarter. That's -- you attributed some of that to VIEVU. Was that -- a couple of questions. One, was it up year-over-year? And secondly, what had it been up quarter-over-quarter organically?

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

Yes, organically, it is up.

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

Quarter-over-quarter? As well as year-over-year?

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

Quarter-over-quarter, it's also up. Yes.

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

Okay. And then, obviously, appreciate the guidance for the second half of the year. Any more you can add just in terms of how we should think about the cadence? Typically, Q4 has been materially better than Q3. Would you anticipate sort of a similar pattern this year?

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

Yes, I think that's typically how we see things go from a seasonality perspective, Steve. So I'd expect roughly the same.

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

Got it. And then lastly, can you just remind me what you said at the Analyst Day just in terms of margin -- or leverage margin expansion beyond this year? It sounds like you're kind of reiterating this year. But can you just remind us how you've had us think about the next several years?

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

Yes, the guidance that we gave, Steve, at the Analyst Day was that we were going to drive 300 to 400 basis points of operating margin improvement every year for the next 3 years. And so we're not changing that to adjusted EBITDA because of the stock-based compensation expense with -- and some of the volatility there with Rick's in plan. But the point is that we're still committing to driving operating leverage within the business over the next few years. We're not backing off that.

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

So still 300 to 400 basis points, just a slightly different metric?

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

That's correct.

Operator

Our next question comes from Yuuji Anderson from Morgan Stanley.

Yuuji P. Anderson - Morgan Stanley, Research Division - Research Associate

I had a couple on the TASER side of the business there. First, can you help us unpack the growth between domestic and international just relative to the corporate average? And then somewhat related, can you describe what percentage of the current TASER installed base is on some kind of subscription or payment plan?

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

Yes, this is Rick. I'll take that. I think the split was relatively typical this past quarter between international and domestic. And then in terms of the total base based on a subscription plan, I don't think we published the numbers on what the percentage of the total basis, some of which is because we historically sold more through distributors than direct, and we've been transitioning to more direct over time. It's a little hard to come up with what the -- what we use as the entire denominator of how many of those previous weapons sold many years ago are still in the field. But we've -- obviously, in the published letter to shareholders, we gave the rates for the last 4 or 5 quarters.



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Yuuji P. Anderson - Morgan Stanley, Research Division - Research Associate

Okay. Got it. I mean, just to follow up on the TASER growth. I mean, I guess I was just trying to get a sense of just how much international is growing relative to domestic rather than the actual split.

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

Historically, we've seen international be about 20% of our overall business. There's a little fluctuation quarter-to-quarter. But that trend has held over the last 18 months or so.

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

I think we do expect and I think we started to see that international has been accelerating a little faster than the U.S. And we think that, that trend over the next couple of years. There's a lot of opportunity for international to actually take up a greater percentage of revenue.

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

Yes. As we -- just to add on that, as we look to the future, our goal would be to see international grow as a relative percentage of our overall revenue. And we feel pretty good and confident about that over the next 2 to 3 years.

Operator

Our next question comes from Scott Berg from Needham.

Scott Randolph Berg - Needham & Company, LLC, Research Division - Senior Analyst

I guess 2 here. First one, and I don't know who wants to take this, but I want to see how we should think about organic versus inorganic growth in the quarter with the acquisition of VIEVU. Specifically looking at the Axon Cloud, I know there were some revenues that came over. But just trying to understand how much that revenue growth came from one versus the other. And then maybe looking at that seat count addition, obviously, that was a pretty large increase in the quarter. Try to maybe help us understand how much of that is organic versus inorganic.

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

Yes. I'll take the seat count. And then, Jawad, do you want to take revenue?

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

Sure, sure.

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

So yes, on the seat counts, we had a mix of growth, organic future growth and then the seats added from VIEVU as well as reclassifying some camera seats, which were originally booked as on-premise but were then migrated into the cloud. So new booked seats were up sequentially organically, but we're not going to break it out to any greater level of detail.

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

Yes. On the first part of your question, Scott, on the organic versus inorganic. So on revenue, VIEVU only contributed about 3 -- less than 3% to our revenue growth. And from a margin standpoint, it was actually -- it's at a loss, so it contributed to our loss. Organically, there's actually not much of a -- organically, we have most of the growth coming from the business -- from the core business and didn't even really contribute much to that.

Scott Randolph Berg - Needham & Company, LLC, Research Division - Senior Analyst

Got it. That's helpful. And then kind of a bigger level picture, probably for Rick since he made the comments on the call is, is the transition to the subscription-based plan on the TASER product, does that become more of a push or pull, do you think, over the next, I don't know, 2, 3, 4 years, whatever that time horizon looks like? And I asked the question because, obviously, the percentage of sales coming from a subscription have been a little bit choppy, they're down this quarter, not a surprise. I expect that to vary at least for the short term. But just trying to understand maybe what those levers, pushes or pulls, look like over the short term.

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

Yes. Great question. I would say it's -- probably you'd expect it, it's a mix. We think that there are things that we can do that will make these subscription offerings more compelling in terms of features and services that will help create more pull. So we think that we can really influence that in a positive way. So I guess you can say that's a push, but ultimately, if we can create these interconnections that are even more valuable, it's going to just really stimulate demand. We said we'll give you some more details, but like I said, stay tuned, we do have some -- we think there's some pretty exciting new programs that will be in a position to launch now.

Operator

Our next question comes from Mark Strouse from JPMorgan.

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

So I apologize if I missed this, my line cut out for a bit. But just wanted to get some more color on Axon Dispatch. Can you just kind of talk about what the -- I know it's early, but kind of what the view is and how that is different versus the competitors that are out there. And then how we should think about timing of commercial availability. And then also, I guess, is that investment for that new segment, is that contemplated in the long-term targets that were given at the Analyst Day as far as margins?

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

Yes. So let me take this one. In terms of -- you can think of Dispatch as sort of the more real-time communications, whereas Records tends to be more of the post-incident historical data that's collected in reports that have been put through the business processes all the way to prosecution chain, whereas Dispatch is the process of handling inbound calls, managing your resources, communicating to officers, giving them information about the calls that are going on. We see a real opportunity that these systems really want to be integrated tightly. The most pure record that you have is the video of the incident itself. Videos send out a lot of unstructured data in them, so the records of structured data. And, of course, we're working on tools to extract structured data from the unstructured data. And, of course, bringing that into a more real-time environment makes that information more actionable with the individual officers. So they're making decisions as -- and they're getting smarter as they're going in to these situations. We've seen -- I mean, the fact that it's even called computer-aided dispatch, we note with a little bit of (inaudible), what other types of dispatch would we expect in the world today. These are pretty dated systems, so we tend to see some really pretty old software that's just been sort of so heavily integrated into a bunch of other things that's sort of ossified into a really challenging user experience. And we see the opportunity to leverage the network. It will be built from digital evidence into records and bringing it all real-time with Dispatch. So we see these



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-- all these pieces coming together in a very cohesive way. And yes, we -- as Jawad confirmed, but we do have -- it doesn't change any of our guidance that we've given.

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

That's correct.

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

Okay. Okay, that's helpful. And then, again, I apologize if I missed this, but any update on the weapons testing in some of those larger European countries that you talked about in the last quarter or 2?

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

Yes. So those are both progressing. We're not quite at the deal stage yet, but we're seeing positive momentum in the U.K. as well as Italy, our 2 key markets that we're focused on. In the U.K., the chief firearms inspector, Simon Chesterman, made the comment when I was over there in March saying he thought every constable should carry a TASER. And then in Italy, the trials that they started are in progress. I'm actually meeting with a rep from Italy next week. So looking forward to that update. Very confident in expansion in Continental Europe with TASER.

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

We've also seen some pickup of activity and interest in Latin America.

Operator

Our next question comes from Will Power from Baird.

William Verity Power - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

I guess a couple of questions. I recognize it's early, but it'd be great to get any early qualitative feedback with respect to the Records deployment. I know it's just one trial today, but any early learnings there? And then just any color kind of qualitatively around the pipeline of opportunities, increasing inbound interest. Just any further color on that initiative would be great.

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

Yes, I'll take that one. So I think it's just too early for us to be providing any real feedback, I think, at this point. The first users are interfacing with the software, and we've got engineers riding along with them and learning a ton. And I think we're really learning, we're hitting the mark generally. And, of course, there's things that we're tweaking and adjusting. And frankly, we're very agile sort of development loop there so that we're feeding those learnings back in quickly. Pipeline, we are getting a lot of interest. The -- I think customers really see the vision that the more they interact with their Alexa or their Siri or their Google home device, they're seeing that voice to text is not science fiction, but that really -- we'll have the ability to bring this to life in a way that's going to meaningfully impact the way that records are created. I can't give you a quantitative feedback in terms of pipeline. We're not at a stage where it is shared publicly. We do have the International Association of Chiefs of Police Conference coming up in early October. That's typically a place where if you're interested in seeing customer reactions, et cetera, it's a great place to go up the show, get a feel for the competitive landscape. And I believe, Andrea, that we'll be hosting an event for investors in Orlando at IACP this year as well?



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

Yes.

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

Yes.

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

So I think that will be the place where you'd get definitely more color there.

William Verity Power - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

And maybe a similar answer to the second question here, but coming out of Accelerate, looking at some of the new products you announced there Fleet 2, Axon Air, any sense -- any update for -- sense for timing for revenue? I assume those are both more 2019, and I guess there's also been some any early feedback on those products.

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

Yes. So Fleet 2, we'll have revenue, we expect some impact, certainly, by the end of this year. Axon Air is a relatively new product for our customers. We don't think it's going to be material this year. But we view that as really creating the framework for another very interesting business over the next 3 to 5 years. And Fleet 2 was really a lot of iterative feedback from Fleet 1. And as we mentioned in the letter, we believe that Fleet 1 has become the top-selling car -- in-car video system within its first year of shipment, which is pretty remarkable. And Fleet 2 really enhances the major points of feedback that we've gotten on Fleet 1. So we do expect that Fleet 2 should have an accelerating impact on our ability to continue making impact in the in-car space.

Operator

Our next question comes from Jeremy Hamblin from Dougherty & Company.

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

I also wanted to ask a follow-up question on Axon Air. Just in terms of the partnership you have with DJI there, can you talk a little about how managing that business? It sounds like it's going to be a little bit more of an outsourced model with you really leveraging your selling network. But can you talk to, one, the kind of the TAM that you expect for that particular product? And then two, in terms of thinking about margins and kind of the cost ramp because you're partnering with them, do you expect that to be profitable more quickly than maybe some of your other products?

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

Yes. So I'll take this one as well. So we do have a great partnership with DJI. So we will be reselling their hardware. And that will, obviously, be much lower margin than when we're reselling -- or when we're selling our own hardware. But we do see significant opportunity in value-added premium software services. So we are building out the team to really sort of build out a long-term drone road map in the software space. So this isn't like a 1- or 2-quarter sort of topic. This is -- we're laying the foundation. Your drones create new types of metadata related to managing a fleet of drones relating to flight data. There might be incremental audit controls to be put in place given some of the privacy concerns people have about how drone to use, et cetera. So I'd say this is -- it's certainly much deeper than us just buying drone stock in the warehouse and having our salespeople ride horse. We see that there are subscription software services that will go with those drones, leveraging our training network to provide trainings



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to drone pilots in the field. I don't want to speak on behalf of DJI, but in our discussions, I would say in terms of (inaudible), it was quite an area of interest given our training infrastructure for training cops, how to use TASER Weapons. To be able to use that -- those similar resources and infrastructure to train pilots on drones was pretty important in making this a (inaudible) partnership for them. It's -- I think it's a little premature for us to sort of setting out a path to where we think it's going to be profitable. But the good news is we're not going to be incurring a lot of hardware development costs. There will be some software development costs, but I do think overall that this is not going to be one of those heavy-lift huge investments over years before we're seeing a return. This one, it's a much more sort of lightweight cost of profitability.

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

Okay. Great. And then I just wanted to ask a question on the weapons segment. You had some really nice, I think, 110 basis points of gross margin improvement year-over-year. But the operating margins were down about 520 basis points. Can you just give me a little color in terms of that change in profitability? Was this just allocation of costs as you're selling more kind of packaged deals? Or can you just give me some color on that?

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

Jawad?

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

Yes. We had -- broadly speaking, Jeremy, we had an increase in OpEx. And these are investments the team needed to make in the business. So we had some OpEx at the TASER segment. We also had some -- those to distributors that are typically at lower pricing. And we talked about before the way that we allocate our costs and we tend to have more of an allocation to the TASER segment. So when we have an increase in OpEx across the business, it tends to hit TASER more broadly.

Operator

Our next question comes from John Weidemoyer from William Blair & Company.

John Gregory Weidemoyer - *William Blair & Company L.L.C., Research Division - Associate*

This is for Jonathan Ho. So again, on the drones -- so related to drones, how big of an -- excuse me, how big is the drone opportunity relative to the fleet of body camera market?

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

Yes. It's a little hard to say right now. Just -- the future is hard to predict. I mean, you could imagine a world where every police car has a drone associated with it or if we go further down field, you can imagine maybe even drones that are pretty in place that might be greater than the number of patrol cars. So I think it's sort of anyone's guess as to how significant the drone market will be long term. But we do see that there's real advantages to being able to have oversight over the top of the scene both visually and to be able to use them as communication hubs, to be able to jump wireless communications. There's a lot of interesting things that could be done with drones. But it's just going to be really hard to predict how that market is going to evolve. This may base a lot on your customer feedback.



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

Yes, I would add one point on Axon Air. This is one where we definitely see the market is pulling this technology. And they're coming to us saying, hey, help us understand how do we package this in such a way that we can have a simple, easy-to-use workflow. And that's where we see the real benefit of the Axon Cloud and the network that we've developed.

John Gregory Weidemoyer - William Blair & Company L.L.C., Research Division - Associate

Okay. That's very helpful. Another question, your -- now that you've had the Officer Safety Plan and subscriptions for your weapon, have you seen any sort of a change in buying behavior by police departments where they might be upgrading, stepping up their upgrades to take advantage of it? Or do you think it's more gated by budgeting in the RFP process?

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

So compared to a few years ago before OSP, I'd say, we're definitely seeing an increase in the percentage of weapons that are being bought on subscription. We started first doing variants of municipal leases, well, maybe 6 or 7 years ago with very lower tax rates. And I think, over time, as agencies have begun to get used to subscription on the SaaS side of the business, it was LAPD who actually, I think, first came up with the idea of bundling together TASER Weapons with cameras and software into one easy to budget for a subscription price. And we've seen it generally up trending. Again, there's some noise quarter-to-quarter. And I'd say, we have seen that, that has increased the velocity of sales. The agencies that previously may have wanted to buy 100 weapons a year over 5 years so they can fit it into their budget will buy 500 weapons now and pay for them over 5 years. And the great news there is that doesn't just bring out one set of orders forward, but now when we get to year 6, all their weapons are 5 years old, and so we're -- and they've already got the budget line item in place. So it's far higher likelihood that they then replace all those weapons at the beginning of year 6. And now we get 2 or 3 sales cycles within a 10-year period, whereas, historically, if they've done this phase rollout, the (inaudible) get into is in year 6, so like a good portion of weapons are still pretty new and most just don't want to have mixed fleets. They don't want to have half X26s and half X2s. So what we saw in that historical buying pattern is once they finish the multi-year rollout, then you got to sort of wait until the last batch of weapons is sort of coming out of its useful life. So you wouldn't see that first upgrade probably for 9 or 10 years as opposed to right at the end of your buy.

Operator

Our next question comes from Mike Latimore from Northland.

Bailey DeMets

This is Bailey on for Mike Latimore. I know you guys said that your international segment is growing faster than the U.S. Do you see that this might change your EBITDA margins and your basis points that you guide for the next few years?

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

So just to clarify that, we've historically seen international come in at about 20% of revenue. We see our international pipeline is growing faster relative to a percentage. And so we're optimistic about future international expansion. We're also growing our overall revenue in domestic business very well. So this means work ahead of us just to realize those sales.

Bailey DeMets

Got you. So I guess as a follow-up, do you see that changing the margins at all? I guess, can you just give a little bit more color about how we should think about that?



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

So weapons margins are relatively the same across international and domestic. In some of the earlier international markets, we're seeing more of a pull for just a body-worn camera. Morocco is one of our big deals, where they don't have the infrastructure for Axon Cloud today and so they started with a body-worn camera deployment only. And so there's some deal mix on margins in that segment.

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

So we do see international across the board tends to start a little lower on margins, but we are seeing international margins overall are increasing steadily.

Bailey DeMets

Got you. And then -- that's great. And then just as a follow-up question, do you expect body and fleet camera sales to be the main SaaS revenue driver? I'd assume that Records will be the main one thereafter, but how should we think about that?

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

Yes, I think -- go ahead, Jawad.

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

Sorry. In the near term, we've got a lot of the mix in our Evidence.com enabled services like body camera, fleet. And so over the near term, that's going to be the main driver. But as Records and Dispatch come online, we think that ultimately, that's going to be the majority of the growth in the business from a cloud perspective.

Operator

(Operator Instructions) Our next question comes from George Godfrey from CL King.

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

Just a couple here. The seat count added this quarter roughly 80,000. If we look at the organic adds and the reclassification of Axon, I'd say 35,000. Is 45,000 a reasonable seat count for VIEVU?

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

Yes, we're not going to go into -- sorry, for strategic reasons, we don't want to go into like splitting those numbers up in any finer detail.

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

Okay. Shifting over to the TASER Weapon base. What is the installed base of the TASER Weapon right now here in the U.S.?



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

Jawad, I'll kick that over to you for what you think for the estimate on the installed base on TASER Weapon.

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

Yes. We believe that to be about 450,000.

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

450,000. So about a 10% increase, I want to say, from roughly 2.5 years ago.

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

That's a fair assumption.

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

Okay. The cameras count of 300,000 we ended this quarter with, what milestone or metric are you waiting for before you start segmenting that domestic versus international?

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

I don't know that we set a firm metric before we start segmenting those out.

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

Well, that's my question. What are we waiting for?

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

Go ahead, Jawad.

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

At this point, as Rick and Luke both mentioned earlier, we're still establishing our presence in the international markets. And there are some early retail accounts that we're trying to win -- or that we've won, and there's some pricing that's not really indicative of what this business is going to look like long term. And so at some point, it will make sense when that business is more mature to split it out, but at this point, it doesn't really add a lot of value.

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

Okay. And then my last question, as it relates to the artificial intelligence and machine learning that you call out on your press release, thinking about the facial recognition software, two questions. One is, if you embed facial recognition technology into your existing camera base, do you think that's a feature you charge extra for? Or is that an ongoing upgrade to the existing subscription? And then I have one follow-on to that.



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

So at the point when we do something like facial recognition biometrics, likely that would be a premium service. That would be something that just happens within existing contract. I would also give the caveat that we've gone pretty careful that we're not yet -- we don't have a time line to launch any facial recognition. We do not have a team actively developing it. This is a technology we don't believe that, sitting here today, the accuracy thresholds are right where they need to be to be making operational decisions off the facial recognition. But once we see sort of daylight to where it will meet the accuracy thresholds and once we've really got a tight understanding of the privacy and accountability controls that we need to ensure that it will be acceptable by the public in large, at that point, we would then move into commercialization of that capability. But this is one where we think you don't want to be premature and end up either where you have technical failures with disastrous outcomes or something where there's some unintended use case where it ends up being unacceptable publicly in terms of long term of the technology.

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

Got it. And then my last question, you mentioned the 30 petabytes of data. Are there legal restrictions where police departments, even if they want to share data between Seattle and Chicago, they can't? Or under your agreements, they're obligated to do so?

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

No. Under our agreement, the data belongs to the customer. They have to opt in specifically to any use of their data. And then, certainly, there are local guidelines or restrictions that may impair whether or not they're intending -- whether they can share that data across to other jurisdictions, et cetera. But we do find in many cases that we now (inaudible) this accredited AI training center where we have a staff that has been cleared to the same standards as other law enforcement agencies that are able to help create training in inference data off of the underlying data enough to train our models. And we are having agency customers that are opting in to participate in those programs. But they do have to opt in.

Operator

Our last question comes from Saliq Khan from Imperial Capital.

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

One question from my end. First one being is, you've done a pretty great job of introducing several new offerings over a very short period of time. Are you concerned about being spread too thin? And what are you doing to be able to ensure the success of all the programs that you have recently introduced?

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

Yes, great question. So 2 of our key metrics that we focus across our entire business is net promoter score and usage. And so we really want to make sure on a quarterly basis and even on kind of a daily and feature set that we're measuring our customers using the product that we're creating and would -- they give us a positive recommendation. And so we've got a very tight feedback loop for monitoring these systems daily to see are they using and would they recommend. And we've got really, really good customer feedback. I would also say our Axon Accelerate Conference is just a great kind of testament to the customers' satisfaction with the Axon network. We actually sold Axon T-shirts and swag. And our customers bought like \$24,000 worth of Axon swag, which is just, I think, an incredible testament to the affinity that they have for the Axon kind of brand and network.



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

Yes. The other thing I would point out is there is an incredible value to having systems that are integrated and just work well together. And one example I can give you is our -- if you stack up Fleet 1, our in-car fleet system, against most of the in-car systems out there today on a feature by feature basis, like there's a lot more features in the incumbent systems that are out there. But where our system really shined was it played really well with body cameras. There was a lot of tight integration between them. On the back end, being able to do multi-camera safe tab, all the information stored in one system that can be shared across peers, et cetera. And that seamless integrated user experience was far more important than a list of 9 (inaudible) user features, et cetera. Now some of those features were things that were causing customer pains, which is why we had a very fast cycle time from Fleet 1 to Fleet 2. But we believe in each of these segments we're going into, the key advantage we have is if we just make it integrated well and easy to deploy with great customer service and training, that we're going to provide a much better user experience and be able to rapidly gain market share and learn from the customer on which of those incremental features we need to bake back into the product. So we do think the network effects, they are particularly compelling for the end user.

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

Great. And then as you continue to build out the end-to-end public safety platform, are you finding you're having more success or more successful conversations either in the field, the station or in the courtroom? Where are some of these lower-hanging hanging fruits for you?

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

It's a great question. I would say we're definitely -- the conversations are getting easier and easier over time. When we first launched cameras, geez, how long ago was it now, 8 years ago, I didn't know there was a ton of skepticism that, wait a minute, you're a weapon company, you're going to do cameras and cloud software? Well, a, what is that? And then b, like how do we know that you're the people to develop it? I think having delivered on a number of successive transformational product experiences, we've gained a ton of credibility with our customers. Many of them tell us that Evidence.com is the most reliable and enjoyable software that they use on a day-to-day basis. So I think as we extend into things like Records and Dispatch, we are -- we're finding very hungry user base for better user experiences. And now we're continuing to see -- the most program is still with law enforcement agencies themselves. But obviously, we've extended now into prosecution. It's extending from there into defense attorneys in the court. So there's certainly a ton of opportunity for us to continue to expand the network. We just want to make sure that we stay focused on -- the most important thing is that we have a really solid core in law enforcement as we then begin to stand out further into the broader public safety agencies.

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

Great, guys. Just one last question on my end. And that is, how are you being impacted by any other budgetary or political constraints?

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

We've not seen any slowback when we sit across from customers, certainly in the U.S. but really around the globe. They are saying, we've got a need for your products and we've not seen budget being an issue.

Operator

Our last question comes from Brian May from Morgan Stanley.

I show no further questions in the queue at this time. I'd like to turn the call back to the CEO of Axon, Mr. Rick Smith. Please go ahead with closing remarks.



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

Great. Thank you. So you see this last quarter and, frankly, the last several years, we've really been focused on driving ARR, annual recurring revenue, and bookings rev. And you can see we continue to make solid progress there. Thanks for those of you who are relatively new, who've joined us since the secondary in May. We really do believe that sets up a foundation where we've now frankly helped to align our investor base with the mission of the company. It's been a lot of work to transition from a manufacturing company into the leading cloud provider of software and connecting devices in a public safety market. And transitioning to bringing in investors who are excited about and supportive of that vision is really great. We believe we've got alignment across all of our stakeholders now, investors, employees and customers. And stay tuned, we're going to use those resources creatively to continue to solve big problems, to continue to accelerate our reach into our customers. And the next quarter, we'll have some really exciting events. I'd encourage you to get a chance to come and visit us in one of those. We'd love to get you -- to know you all a little bit more personally. And stay tuned as we continue to protect life and save the world together. So thanks for joining us today.

Operator

Thank you, ladies and gentlemen, for attending today's conference. This concludes the program. You may all disconnect. Good day.

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