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# Axon Enterprise, Inc. (AAXN)

Q3 2019 Earnings Call

## CORPORATE PARTICIPANTS

**Andrea James**

*Vice President-Investor Relations & Corporate Strategy, Axon Enterprise, Inc.*

**Patrick W. Smith**

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

**Jeff Kunins**

*Chief Product Officer & Executive Vice President-Software, Axon Enterprise, Inc.*

**Luke Larson**

*President, Axon Enterprise, Inc.*

**Jawad A. Ahsan**

*Chief Financial Officer, Axon Enterprise, Inc.*

**Joshua Isner**

*Chief Revenue Officer, Axon Enterprise, Inc.*

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## OTHER PARTICIPANTS

**Joshua Reilly**

*Analyst, Needham & Co. LLC*

**John Weidemoyer**

*Analyst, William Blair & Co. LLC*

**James E. Faucette**

*Analyst, Morgan Stanley & Co. LLC*

**Ryan Ronald Sigdahl**

*Analyst, Craig-Hallum Capital Group LLC*

**Keith M. Housum**

*Analyst, Northcoast Research Holdings, LLC*

**Charles Erlikh**

*Analyst, Robert W. Baird & Co., Inc.*

**Charlie Lowell Anderson**

*Analyst, Dougherty & Co. LLC*

## MANAGEMENT DISCUSSION SECTION

**Operator:** Good afternoon. My name is Robert, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Axon Q3 2019 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session at which time instructions will follow.

I will now turn the call over to Andrea James, VP of Investor Relations and Corporate Strategy. You may begin your conference.

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### Andrea James

*Vice President-Investor Relations & Corporate Strategy, Axon Enterprise, Inc.*

Thank you, Robert. Hello, everyone. Welcome to Axon's third quarter 2019 earnings conference webcast. Here in the room in our Scottsdale headquarters we have Axon's CEO, Rick Smith; President, Luke Larson; CFO, Jawad Ahsan; Chief Revenue Officer, Josh Isner; and a new comer, Chief Product Officer, Jeff Kunins.

I hope you've all had a chance to read our shareholder letter which was released after the market closed. You can find it at [investor.axon.com](http://investor.axon.com). Management's remarks today are meant to build upon the information in that letter. During this call, we will discuss our business outlook and make forward-looking statements. Any forward-looking statements made today are pursuant to and within the meaning of the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995. These comments are based on our predictions and expectations as of today and are not guarantees of future performance. All forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially. These risks are discussed in our SEC filings.

You can go ahead, Rick.

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### Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

Hey, everybody. Welcome to the call. We're having a pretty good day here and appreciate you taking the time to join us. We're pleased with our financial performance and our product execution in the quarter. We achieved several of our 2019 objectives in rapid succession in Q3 which we outlined in detail in our shareholder letter. The achievements we unlocked since our last update support our vision of creating the best-in-class technology ecosystem for public safety. We want to empower patrol officers to be more efficient, more effective. And the ultimate end result will be fewer tragedies, greater transparency and safer communities.

Over the past year, our board of directors and myself and the rest of the executive team undertook an extensive talent search for our Chief Product Officer.

I'm incredibly pleased to welcome Jeff Kunins to the company. It's been rewarding to work alongside someone with more than 25 years of high impact product experience. Most recently, as a VP on Amazon Alexa team and [indiscernible] (00:02:40) leverage that talent to work on solving problems for our customers in public safety. Jeff is already adding value to our long-term strategy discussion. He will be a key partner in helping us to scale across the more diverse range of products we're now aggressively delivering for customers.

Those of you who've been with us for a while know that we get very close to our customers. We spend a lot of time listening to what they want in designing products to make their life easier. So, as we do with all of our new talent, we put Jeff through a substantial onboarding process. He's participated in several ride-alongs in patrol cars, including an overnight shift in what we'd call an active city. He's also doing a fair number of sit-alongs with record clerks in agency back offices and in 911 dispatch centers observing the call taking and dispatching process, which is the next category we are bent to disrupt.

Jeff, maybe take a moment and talk about your first impressions why you came to Axon and the opportunities you see here.

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## Jeff Kunins

*Chief Product Officer & Executive Vice President-Software, Axon Enterprise, Inc.*

Thanks, Rick. I'm thrilled to be here. In my experience, one of the most critical things that makes a company successful is simply the culture, which shines through at Axon that I can see already is the bold audacity to invent amazing things on behalf of our customers and the communities they serve paired with a healthy dose of humor and humility.

At this particular moment in history, the specter of gun violence and threat to social justice around the world have created the need for millions of people to both feel more safe and be more safe. So it's an unprecedented honor for me and a privilege to be part of what we do every day here at Axon.

For a little context on who I am, first and foremost, I'm a builder. For the last 25 years, I've had the privilege to work on software, services and devices in one form or another that have been used by millions of people and have supported multibillion-dollar businesses around the world in a diverse range of contexts. I tend to be hands on, dive deep and be customer obsessed. In Amazon, relentlessly focused on finding new ways to truly delight customers and keep doing that effectively at ever bigger scale across an ever more diverse range of products. And I see that same passion and commitment at Axon.

One of the most exciting things about Axon is our opportunity to create software devices, cloud services, SaaS subscriptions and mobile apps that all work together to create a flywheel effect of customer loyalty and long-term value. And that business model is incredibly compelling. For a still little more perspective on why I joined Axon beyond the business model, beyond the opportunity, look, I loved Amazon. I love Amazon and was very happy there for 5.5 years with zero intention of making a change, and in particular I was thrilled to be a part of Alexa and helping invent the future of cloud-based voice assistance especially having spent previously eight years of my life at Tellme Networks, one of the early pioneers in that space. But a member of Axon's board was instrumental in introducing me to the company. And then three things happened in quick succession that convinced me I had no choice but to join Axon and its mission to protect life and obsolete the bullet.

First, there was a shooting just a few miles from my children's elementary school, and one of the teachers was shot. Thankfully she survived, but it brought the reality of the world we're all living in much closer to home. Second, I attended a fundraiser with a bunch of other Seattle tech leaders where the father of one of the Parkland Florida shooting victims told the room that donating money is great, but challenged all of us by asking if you really care, what are you personally going to do about this significant problem facing our society today. And then third, literally that same day, I saw the announcement about Rick's upcoming book, *The End of Killing*. I ordered it on my Kindle, of course, and I got two chapters into the book, and I decided okay, I just have to talk to them.

So clearly, I'm a big believer in Axon's mission. I'm honored to be here and my first seven weeks of the company have done nothing but reaffirm my confidence in our tremendous opportunity ahead.

Now, I'll turn the call over to Luke.

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## Luke Larson

*President, Axon Enterprise, Inc.*

Thanks, Jeff, and welcome. In his first seven weeks, Jeff is already making a great impact and thank you to those members of the investment community who came to the International Association of Chiefs of Police Conference in Chicago last week.

For those of you that attended, you were able to see firsthand the buzz at Axon's booth and the positive feedback we get from our customers. At Axon, our north star is to drive adoption of our high value integrated bundles which marry our hardware devices and cloud services into one monthly recurring payment. It's clear that the customers see a lot of value in cloud services we're offering, so we made it easier for them to purchase by combining all of our offerings into one integrated OSP bundle. This strategic sales pivot has been a huge success, helping us to drive substantial momentum on the software side.

The way we sell the most software is through these bundles. OSP 7+ is our most popular bundle this year among the top 1,200 public safety agencies in the United States. In the first three quarters, we booked more than 11,000 feet on OSP. Across dozens of agencies, and we expect that number to accelerate, by the end of the year, we aim to have more than 100 agencies on our highest value Officer Safety Plan. OSP is a critical mechanism for helping us to drive customers to Axon Records. This is because OSP creates the purchasing mechanism for records transaction. This obviously puts us in a very favorable position and consequently the pipeline for Axon Records is very robust. These plans not only drive our software average revenue per user substantially higher, we are seeing monthly ARPUs double and triple, but the plans also maximize the value we are delivering for our customers.

The way we ensure we are delivering valuable services is by looking at usage of our products, which also drives customer retention. Having a near zero churn rate, we think is also a testament to the value we are providing for these agencies.

Now, I'll hand the call over to Jawad, our Chief Financial Officer.

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## Jawad A. Ahsan

*Chief Financial Officer, Axon Enterprise, Inc.*

Thanks, Luke. This is an incredibly exciting time for Axon. We're executing and scaling at a rapid pace and we continue to grow our network of cloud connected devices and cloud services that deliver real value to our law enforcement customers. I'd like to focus my comments today on how we're tracking toward our long-term targets.

The product milestones we achieved this year are driving a reacceleration on the top line in the back half as we expected and positioned to achieve our increased expectations for 2019 revenue growth of approximately 20%. Heading into year end with this momentum, sets us up nicely to continue delivering against our long-term target model.

We're very successfully building a high margin SaaS business on top of our existing hardware business. One of the ways we measure progress here is by disclosing annual recurring revenue or ARR. As of Q3 2019, we are delivering nearly \$142 million in high margin ARR which is up 39% year-over-year. For the past six quarters, ARR grew nearly \$10 million incrementally on average per quarter and we expect this trend to accelerate in 2020.

Let's take a look at what drives leverage both on the gross margin line and on the adjusted EBITDA margin line. First, the software portion of every contract we sign with customers carries an 80% gross margin and that's including storage in compute costs. As most of you know, under GAAP, our hardware revenue must be fully recognized at the time of shipment while software revenue is amortized over time. What this means is that on an Officer Safety Plan integrated bundle, even though the five-year direct gross margin on the contract is above 70%, it takes a while for that margin to build. We expect to continue seeing that play out in our P&L as our business is scaling and we're driving strong growth in hardware from both new products and markets.

This means gross margins can be lumpy quarter-to-quarter but we're more focused on driving the long-term underlying trend. At a high level, you can expect to see us continue scaling the hardware business and using our growing network of devices to drive more high margin cloud services.

For adjusted EBITDA, we see ourselves as building a business that supports a long-term target margin of 30%. In the third quarter, adjusted EBITDA margin was about 18%. Our incremental adjusted EBITDA margin compared with Q2 was 68% demonstrating that we're successfully driving leverage on incremental revenue while continuing to invest for future growth. We did this through a very intentional approach to capital allocation, driving leverage in G&A and reinvesting it in R&D, as well as through rigorous cost controls.

Our growth outlook remains strong. As you saw in our shareholder letter, we're seeing early success in several new adjacent markets, which allows us to sell our core products to new customers, including federal law enforcement, corrections and international markets. You can expect to see us continue to expand the breadth and depth of our product offerings, while also tapping new customers and markets to drive long-term growth and increase our total addressable market. You see a tremendous opportunity to create an even broader ecosystem of products and services that will allow us to continue delivering value to our customers, communities and stakeholders.

And with that, operator, let's go to questions.

## QUESTION AND ANSWER SECTION

**Operator:** Certainly. [Operator Instructions] Your first question comes from the line of Scott Berg with Needham and Company. Please go ahead. Your line is open.

Joshua Reilly

*Analyst, Needham & Co. LLC*

Q

Hey, guys, this is Josh on for Scott. Congrats on the strong quarter. With the TASER production issues related to the battery now resolved, you mentioned the cartridge issue in the letter. I wanted to get some more color on how that's progressing. How many cartridges are you shipping currently with the new TASERs? And where do you expect to get this to in 2020?

Luke Larson

*President, Axon Enterprise, Inc.*

A

Yeah. Great question, Josh. So, to answer the first part of your question, the battery issues are 100% resolved. And with the cartridges, why don't I have Rick answer that. He is pretty close to the detail.

Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

A

Having built the first ones in the garage, yeah, I have an affinity for our cartridges. So, we're feeling really good about where we're at with getting the design. The design modifications we talked about earlier this year. Those are through revalidation. We're in production. We're feeling really good about it. In terms of the number of cartridges per handle sold, with TASER 7, it typically includes about 12 cartridges in the first year and then there's recurring cartridges in the out years which on the plans are typically around 12 cartridges per year as well. But we don't recognize revenue on the future cartridges until they ship at the anniversary date from when we shipped it in – from the first receipt of the order.

Joshua Reilly

*Analyst, Needham & Co. LLC*

Q

Okay. Great. And then just a financial question. You raised the revenue guidance nicely up the Q3 beat. Are there any other factors other than the TASER gross margin not allowing the excess revenue to flow through to EBITDA here in near term?

Jawad A. Ahsan

*Chief Financial Officer, Axon Enterprise, Inc.*

A

Yeah. This is Jawad, I'll take that. So, we – essentially, we're looking at the full year delivering \$80 million to \$85 million, and unfortunately we had some headwinds earlier in the year with the manufacturing challenges on the TASER weapon. And those are going to be difficult for us to overcome which is why we left the EBITDA margin at the current guidance of the previous guidance to \$80 million to \$85 million, but we are going to see strength in revenue.

Joshua Reilly

*Analyst, Needham & Co. LLC*

Q

Thanks, guys.

**Operator:** Your next question comes from the line of Jonathan Ho with William Blair and Company. Please go ahead. Your line is open.

John Weidemoyer  
*Analyst, William Blair & Co. LLC*

Q

Hi. Thanks for taking my question. This is John Weidemoyer for Jonathan. I would like to talk about your pipeline for your OSP – well, your OSP in general. I'm wondering about the pipeline of major city deals for OSP 7, OPS 7+ that you see your confidence in the visibility and such. And I also have a question about a statement you made in the shareholder letter. If I'm looking at it correctly, in the US, your percentage of weapons that were sold through the OSP is 64% and overall 55%. So, I'm wondering if that tells me that outside the US, it's closer to 50% or even below 50%. Can you talk about the dynamics there that might be different and how – and what might be done to get that to be a higher percentage?

Joshua Isner  
*Chief Revenue Officer, Axon Enterprise, Inc.*

A

Okay. So to answer the first question on the OSP adoption amongst US customers, we're very pleased with the adoption through three quarters here. This was a program that was launched on January 1. And frankly, we were expecting a little more of a ramp-up to when these would turn into purchases. But our customers have been extremely excited about them and we've closed roughly 70 to 75 of them through three quarters and we expect that number to exceed 100 by the end of the year. I think long term, we view this is the purchasing mechanism for at least mid-sized and large agencies and hopefully smaller agencies as well.

So, to answer your question, we're very confident that number of licenses continues to grow nicely. I think a side effect of that which is also very positive is the fact that this essentially sets up the pool of prospects for RMS customers for us as well. So, very, very pleased with the momentum that OSP 7 and OPS 7+ have provided this year, and I believe it will continue.

On your second question, just so I understand, the question was the mix of OSPs between domestic and international customers?

Andrea James  
*Vice President-Investor Relations & Corporate Strategy, Axon Enterprise, Inc.*

A

Just a point of clarification, John, the 64 % in the US is on a recurring, it's Officer Safety Plan plus some sort of TASER subscription like [ph] this sort of (00:17:52) plan.

Joshua Isner  
*Chief Revenue Officer, Axon Enterprise, Inc.*

A

And the question is why is that lower internationally?

John Weidemoyer  
*Analyst, William Blair & Co. LLC*

Q

Correct.



Joshua Isner

*Chief Revenue Officer, Axon Enterprise, Inc.*

A

It comes down of the fact that we are still driving toward great product market fit in some international markets. I think we've achieved that in our Tier 1 markets and we are on the verge of achieving that in some of our Tier 2 markets. But across the world, we certainly still have work to do to get to the point where tasers and body cams come together for every police force, and there's some circumstances where that might depend on cloud infrastructure in some of these markets. And so, we are confident that we see this trend continuing in Tier 1 and Tier 2 markets and each year, hopefully, we see more and more of those markets start to appreciate the value of the cloud plus CWs plus on-officer cameras as a combination.

Luke Larson

*President, Axon Enterprise, Inc.*

A

Great, great question, John. Just for a point of clarification, that was Josh Isner, our Chief Revenue Officer.

John Weidemoyer

*Analyst, William Blair & Co. LLC*

Q

Okay. Great. Thank you very much. If I could ask one more question. Can you just talk to the competitive landscape and any – if you have any updates to the competitive response to your new product lineup?

Joshua Isner

*Chief Revenue Officer, Axon Enterprise, Inc.*

A

I can take that as well. Look, we believe we have the best channel combined with the best products, and we think both of those are huge competitive differentiators for Axon moving forward.

John Weidemoyer

*Analyst, William Blair & Co. LLC*

Q

Thank you very much.

**Operator:** Your next question comes from the line of James Faucette with Morgan Stanley. Please go ahead. Your line is open.

James E. Faucette

*Analyst, Morgan Stanley & Co. LLC*

Q

Great. Thank you very much. Apologies for the background noise, but hopefully you'll be able to hear me okay. Jawad, I wanted to ask a follow-up question to your comment that you're looking for faster building of ARR in 2020 than what we've seen in – than we've seen in 2019. Can you explain a little bit the dynamics that will lead to that and what kind of visibility you have on that objective?

Jawad A. Ahsan

*Chief Financial Officer, Axon Enterprise, Inc.*

A

Yeah, look, we've made investments over the past couple of years in things like live streaming, fed ramp, ALPR, other AI services and you're starting to see those investments pay off. In our bookings, it's going to convert into revenue. We've seen a lot of excitement from our customer base for these software services, and that's what's – that's really what's feeding into it. We've already had a – we had a nice base of ARR that was building with our core body camera, Evidence.com product, and we're now adding other services on top of it.

James E. Faucette

*Analyst, Morgan Stanley & Co. LLC*

Q

And I guess just to dovetail with that is that you, as a team, have generally been fairly conservative in addressing your potential TAM and – but from our perspective, we're pleased to see new insertion points that you called out in prisons and correction markets when you talked about expanding the TAM. How do you think about your current product portfolio and the sales strategy to pursue those markets? And I guess maybe more importantly, are there any gaps you think you need to incrementally invest in to start to address these natural adjacencies? Thanks.

Luke Larson

*President, Axon Enterprise, Inc.*

A

I think our goal is to identify adjacencies that don't require product overhauls and just small product tweaks to be successful in those. I think for all of us, it starts with the talented team selling into those markets and we believe our products have an ROI in those applications. So, certainly, moving forward a point of focus for us to continue to expand our TAM and build momentum in each of those adjacencies over time.

James E. Faucette

*Analyst, Morgan Stanley & Co. LLC*

Q

Great. Thank you.

**Operator:** Your next question comes from the line of Steve Dyer with Craig-Hallum Capital. Please go ahead. Your line is open.

Ryan Ronald Sigdahl

*Analyst, Craig-Hallum Capital Group LLC*

Q

Hey, guys. Ryan Sigdahl on for Steve. As it relates to AB3, the live streaming, I guess I'm just trying to reconcile comments today that it is exceeding expectations versus that ICP when I thought you said initial adoption was not as positive as initially expected due to the various friction points. Any help there, I guess, reconcile on those two comments?

Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

A

Yeah. This is Rick. So, yes, in ICP when I got the question I wasn't saying that it wasn't meeting our expectations. All I was saying there was that when you're deploying something new like live streaming, that is a change that's going to require – the customers are adapting to that new capability. So, I was just tempering expectations that this isn't a market where at the moment something is available, everybody immediately turns it on. You have to work through policy issues; you have to work through things like working with unions, et cetera. So, there, I was just merely pointing out that as excited as we are about live streaming, they're just like every service we drive. There – it's going to be work to getting an adopted and scaling with the customer base.

I would contrast that with the comment that it's exceeding our expectations, and that with the cameras that are going out in the field, we're getting very positive responses from customers. And so, we believe we are successfully executing against those operational challenges of rolling out a new service.

Joshua Isner

*Chief Revenue Officer, Axon Enterprise, Inc.*

A

And it's important also to say, this is Josh again, that by virtue of OSP 7+ sales we have 11,000 users of Aware and Aware Plus ready to turn on as soon as they receive their cameras, and that number will continue to grow. So, it's a good place to start to have 11,000 licenses there, and we believe we are on a path to every camera, that is our goal that every camera turns into an Aware and Aware Plus camera.

Ryan Ronald Sigdahl

*Analyst, Craig-Hallum Capital Group LLC*

Q

Great. One more from me. Given TASER 7 production targets at 65,000 units this year and you've shipped 35,000 through 9 months here, should we assume that you also expect a significant ramp in sales in Q4? Or are you guys planning to build some inventory heading into 2020 based on kind of the pipeline you see? Thanks and good luck.

Luke Larson

*President, Axon Enterprise, Inc.*

A

I'm not sure we're going to comment on the exact pipeline in Q4, but we think it is sufficient to satisfy Q4 demand. It's also a strategic priority as some of these larger T7 deals formulate over the coming quarters that we do have flexibility with inventory to be able to service those.

**Operator:** Your next question comes from the line of Keith Housum with Northcoast Research. Please go ahead. Your line is open.

Keith M. Housum

*Analyst, Northcoast Research Holdings, LLC*

Q

Good afternoon, guys. Hey. If I can you just reach back to a question earlier in the conversation in terms of the cartridges, was [indiscernible] (00:24:54) backlog here as you ended the quarter and what's that look like as you look into the fourth quarter? If you look at the cartridges number for the quarter, it's down year-over-year at the very least.

Luke Larson

*President, Axon Enterprise, Inc.*

A

I would say, yeah, there is a backlog. It's a consequence of selling so many TASER 7 cert plans to start the first three quarters. We do anticipate clearing that backlog by the end of the year.

Keith M. Housum

*Analyst, Northcoast Research Holdings, LLC*

Q

Great. Is it possible to quantify how much that might be?

Luke Larson

*President, Axon Enterprise, Inc.*

A

We're not going to share that at the moment, but certainly we can commit to our customers that the backlog will be cleared by the end of the year.

Keith M. Housum

*Analyst, Northcoast Research Holdings, LLC*

Q

No problem. I had to try there. Second question, if I may follow-up, a little bit on international business, can you provide some color or commentary on how that's proceeded during the quarter? Thanks.

Luke Larson

*President, Axon Enterprise, Inc.*

A

Sure thing. So, we are very pleased with the execution of the international team. As we talked about before, they'll be kind of a lumpy quarters depending on – just due to the large size of some of the deals we're working on. But our kind of internal metrics that we used to evaluate international continue to look promising and very confident in the long-term potential of our international markets. And I think as we see revenue continue to climb year-over-year here we feel that trend will continue.

Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

A

I might add as well that in the international markets we frequently need to get government approval on new products, for example in the UK or Canada or other markets. So, when the TASER 7 goes on sale in the US, it's not been approved yet in most of those major markets. But we're making a lot of progress towards those approvals. So that will provide a nice accelerant once our premier product is approved for sale on those countries.

Keith M. Housum

*Analyst, Northcoast Research Holdings, LLC*

Q

[indiscernible] (00:26:42)

Jawad A. Ahsan

*Chief Financial Officer, Axon Enterprise, Inc.*

A

Yeah. And [indiscernible] (00:26:42) from a financial perspective, we had really strong bookings and we had \$20 million of revenue.

Keith M. Housum

*Analyst, Northcoast Research Holdings, LLC*

Q

Great. Thank you.

Jawad A. Ahsan

*Chief Financial Officer, Axon Enterprise, Inc.*

A

[indiscernible] (00:26:48).

**Operator:** Your next question comes from the line of Will Power with Baird. Please go ahead. Your line is open.

Charles Erlikh

*Analyst, Robert W. Baird & Co., Inc.*

Q

Yeah. Hey, guys. This is Charlie Erlikh on for Will. Just wondering have you seen much of an impact from the Motorola and WatchGuard tie up either on the [ph] sleep side (00:27:06), body camera side, software? Any comments on that so far?

Luke Larson

*President, Axon Enterprise, Inc.*

A

We're looking forward to competing.

Charles Erlikh

*Analyst, Robert W. Baird & Co., Inc.*

Q

Okay. Fair Enough. And also I'm wondering what you're hearing and seeing from the early beta customers on RMS Fresno and Cincinnati. What's been their feedback so far? And then kind of tied with that, could you remind us about your CAD plans?

Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

A

Yeah. So, let me first take Fresno and then I'll let Jeff take Cincinnati since he went out and visited with Cincinnati. So, I can tell you I was on the phone immediately before and after the deployment with senior leadership at the program management level and the chief level, and the feedback was so positive. The thing that stands out to me was they basically said, we're waiting for like the shoe to drop because they've done big system conversions before and they've never seen them go this smoothly. And they were able to train 800 officers without disruption of the agency. They found that the new software is just dramatically more intuitive and easy to use.

And overall, they became – they actually went to a major – a conference with other major city police chiefs the week after they made the deployment, and that's normally right when things are getting pretty ugly as they explained to us. And in fact they rolled out to that conference and were frankly making lots of really positive laudatory statements and had become a great Records customer. So that's Fresno.

I will say on dispatch, we're not going to give any more insight on dispatch at this point. So let's just – we'll talk about that more [indiscernible] (00:28:52) in the next year. It is our next upcoming big software release, but we're not giving more details.

Jeff, you want to talk a little about the reaction to Cincinnati with Records?

Jeff Kunins

*Chief Product Officer & Executive Vice President-Software, Axon Enterprise, Inc.*

A

Sure. I think that Cincinnati is a great evidence point both of excitement about that we've built so far and of the leverage that the OSP 7+ and other integrated bundles that Josh was talking about earlier provides for us. So, Fresno immediately went to an all agency-wide replacement of their RMS system, and as Rick said that they're been very thrilled with it so far. In Cincinnati, the first thing that they did was they deployed one piece of our new RMS system, call it Standards, and it's for a variety of key critical reports like use-of-force reporting, and they did that alongside their existing RMS for other workloads.

They were so happy both with the performance of our RMS Standards module but also how much they love the user experience and how well it tie in with everything else they were familiar with from Axon that it helps them quickly come to the decision to commit to do an agency-wide deployment of RMS. And because at the exact same time, they signed on for OSP 7+ that makes it an extremely easy purchasing decision for them as well as they roll forward into next year. And they publicly made a press release a few weeks ago to the effect on both points.

Charles Erlikh

*Analyst, Robert W. Baird & Co., Inc.*

Q

Great. And that's really helpful, and congrats on a very strong quarter.

Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

Thank you.

A

**Operator:** Your next question comes from the line of Charlie Anderson with Dougherty and Company. Please go ahead. Your line is open.

Charlie Lowell Anderson

*Analyst, Dougherty & Co. LLC*

Yeah. Thanks for taking my questions. And I've been hopping between calls and I'd like to apologize if these questions have already been answered. But [indiscernible] (00:30:50) gross margins, obviously, had some strength in the camera side or sensor side. I wonder to what degree was that influenced by sort of the usage of the LTE? Is that a factor here to some degree in over a period of time?

Q

And then on the TASER gross margin, as you cut over to the new component on the cartridge, I wonder does that get to [ph] 70% (00:31:10) or you can potentially go beyond with the new [indiscernible] (00:31:13) cost component? And then I got a follow-up.

Jawad A. Ahsan

*Chief Financial Officer, Axon Enterprise, Inc.*

I'll take the first part of that question. Our gross margins in Q3 were not impacted by LTE. The main driver there, we continue to see improvement in the cost structure for the TASER weapon as well as the cartridges as well as the standard operational execution. And then – did you want to take the second part?

A

Luke Larson

*President, Axon Enterprise, Inc.*

Yeah. And then just on that first point, we're also seeing a lot of success with our higher bundle programs we talked about on the call as well. And what was the second question again?

A

Charlie Lowell Anderson

*Analyst, Dougherty & Co. LLC*

It was on the when you make that change on the TASER cartridge, do you expect to go back to [ph] 70% (00:31:49) type area for gross margin because you actually go beyond it?

Q

Luke Larson

*President, Axon Enterprise, Inc.*

We're laser focused on improving the margin. Our primary goal is to get to full production that we have line of sight too. And then as we ramp up to full production, we'll continue to increase margins in Q4 and throughout 2020 as well.

A

Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

Yeah. [ph] I've got (00:32:13) a little bit more color there. Because we did have a cartridge backlog as we were making this change, we expect to have a higher percentage of cartridges in the fourth quarter in the TASER segment than normal, and cartridges do carry a lower margin than the services or the TASER handle in the

A

bundle. So, it's not like there's going to be a snap back to historic margin levels in the fourth quarter. There's going to be some puts and take. The margin on cartridges is improving, but the mix is going to go a little bit the other direction. And in these plans, we also do have services that are sold with TASER 7 that do differ some very high margin revenue out of the quarter of initial shipment and into the future. So that's going to be very helpful. Where over time, we're very happy with the margins of the TASER 7 bundles, they tend not to – they don't show as well in the first quarter of shipping because a lot of those high margin stuff is deferred into future quarters. But obviously over time, that's going to lead a nice continual upward pressure on margins.

Jawad A. Ahsan

*Chief Financial Officer, Axon Enterprise, Inc.*

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Yeah. And I want to make sure I put it crystal clear point on that that our gross margins will be flat to slightly down driven by mix, not driven by anything in the weapon segment because of the cartridge mix as Rick had mentioned, but our objective is still to deliver the \$80 million to \$85 million of EBITDA that's baked into our guidance.

Charlie Lowell Anderson

*Analyst, Dougherty & Co. LLC*

Q

Great. Thank you for all the detail. And then for my follow-up, on RMS, you've obviously got these two customers and I think you sort of referred to them as launch customers or reference customers. I wonder does there need to be a digestion period for them to use it for some period of time before the next tier of customers jump or any commentary on maybe the pace of wins we should expect in the next year on RMS? Thanks so much.

Luke Larson

*President, Axon Enterprise, Inc.*

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Yes. I think to put it simply, our goal is to continue to accelerate adoption of OSP 7+. And starting next year, as I said earlier in the call, like we're expanding this pool of prospects within that universe, we will start to go back and slot those customers in for deployments. And so, the timing depends on not only our customer's timing, but also what their requirements are and so forth, and we're going to be working through that over the next 12 months and beyond. And we certainly expect significant adoption of the platform and very confident OSP 7+ continues to be the mechanism that drives that.

Charlie Lowell Anderson

*Analyst, Dougherty & Co. LLC*

Q

Great. Thanks so much.

**Operator:** There are no further questions at this time. I turn the call back over to the presenters.

Patrick W. Smith

*Chief Executive Officer & Founder, Axon Enterprise, Inc.*

Great. Hey, thanks everybody for tuning in. After our last quarter look, we had some operational challenges in Q2. I can say we really challenged the team and the company here. And in fact, there were some calls with analysts who were wondering why we didn't pull back on our EBITDA guidance for the year given the challenges in the second quarter. And we said hey, we're going to put some grit, we're going to put our shoulder to the wheel here and we're to get it done. And I couldn't be prouder. I mean, there's a lot of smiles in the room here. I mean people worked nights and weekends and really hard to deliver the results that we got in the quarter, and there are still a lot of work to do in Q4, but I couldn't be prouder that we're going to deliver on our commitment. We're committed



to continue to grow a great company, excited to build out the team with some great new board members, and Jeff, and other new employees. And we look forward to talking to you all after the holidays and looking forward to a bright 2020.

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**Operator:** Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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