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Axon Enterprise, Inc. (AAXN)

Q1 2020 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.

Luke Larson

President, Axon Enterprise, Inc.

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

Douglas Sand

Media Arts Manager, Axon Enterprise, Inc.

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

Jeff Kunins

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

OTHER PARTICIPANTS

Scott Berg

Analyst, Needham & Co. LLC

Charlie Lowell Anderson

Analyst, Dougherty & Co. LLC

Jonathan Ho

Analyst, William Blair & Co. LLC

Keith Housum

Analyst, Northcoast Research Partners LLC

William Verity Power

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

Joseph Osha

Analyst, JMP Securities LLC

Erik Lapinski

Analyst, Morgan Stanley & Co. LLC

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Michael Latimore

Analyst, Northland Securities, Inc.

Scott Kessler

Analyst, Imperial Capital

MANAGEMENT DISCUSSION SECTION

Andrea James

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

Welcome to Axon's First Quarter 2020 Earnings Conference Webinar. I'm Andrea James, Vice President of Corporate Strategy and Investor Relations. Thank you for joining us today. Today, we have available Axon CEO, Rick Smith; President, Luke Larson; CFO, Jawad Ahsan; Chief Revenue Officer, Josh Isner and Chief Product Officer, Jeff Kunins.

We're really pleased to bring you the whole team. This team has done dozens of earnings calls together as a public company, but this is the first one where we're all in a different location. Just like you, we're all adapting and we thank our analysts and our investors for joining us today over Zoom. We do appreciate that today is a particularly crowded earnings day and I know there's a lot of calls going on right now.

Our company has really embraced video conferencing technology to keep connected. We're using custom Zoom backgrounds today and you'll see seven of them with our executives. Five of the backgrounds are actual offices of Axon all around the world and then two of them are not real backgrounds. So for analysts, if you're joining us today, you want to guess at which backgrounds are not real, we'll send you some Axon Swag if you get it right.

Okay. So today, first, management will give prepared remarks and then we will bring our analysts on camera for questions. Analysts, your line will be muted until it's time to ask a question. Please ask two questions and if you have a follow up, you can let us know via the chat window. We'll circle back around depending on time. Axon's moderators Mark, Doug and Angel will be unmuting your lines when we call on you and if you get into trouble, type your question in the chat window and we'll read it aloud.

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. And our remarks today are meant to build upon the information in that robust letter. If for some reason, there is an Internet outage beyond our control or we lose Zoom connectivity, we'll make every effort to post a copy of our prepared remarks at investor.axon.com this evening.

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 the predictions and expectations as of today, they 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.

All right. Now let's hear from Rick.

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

Awesome. Thanks Andrea, and thank you to everyone for joining us today. We last spoke with you on our Q4 update call on February 27, and what now feels like a very different world where people ate in restaurants and flew to business meetings and vacations. Three days later, we curbed all non-essential travel for our employees. But our message to our team was very clear that we may curb travel or work from home, it does not mean that we're reducing the vigor with which we pursue our mission. Far from it, we are aggressively adapting to new

conditions in the world as we zoom into all our meetings and we will seek opportunities to use this changing environment to leverage our superior adaptability to gain ground against less agile competitors.

In the past weeks, Axon has brought forth some major initiatives to address this crisis, including giving free global access to Axon citizen for the remainder of 2020 and using our supply chain to source PPE for first responders in a nationwide campaign and partnership with the National Police Foundation, which even got the attention of Vice President, Pence, who tweeted about it. A large number of Axon employees donated money or personal time to this cause.

Our first responders still face significant risks and we are continuing to match donations for PPE. If you, our investors are able to support the cause, please do. Help us protect those who keep us safe. Go to axon.com/covid and scroll down and hit the Donate Now button.

Even though, I've been working from home and getting a lot more time with my kids including some pedicures from my daughter, Fortnite lessons from my son and helping film product demos with my teenager, I personally have had more face time with customers over Zoom than I've ever had even in person. I've been doing about five different Zoom customer meetings a day and that's far higher than was possible when we had to travel in person for in-person meetings.

So my personal customer engagement velocity is way up. And Jawad and I will be attending more investor conferences this quarter than at any time in the past years as we can Zoom into those as well. We're proud to be thought leaders on driving technology adoption. And I'm pleased to see how well our customers have adapted to using this technology to be increasingly productive. I was on three customer meetings earlier today and most of them had never used videoconferencing before the COVID crisis and now it's become standard.

Here's what I'm learning from those customers and what they're telling me. They're working with reduced staff due to personnel being out sick. Customers are seeing this crisis, it's forcing them to adapt and change more rapidly than ever and technology will play an even larger role as a cornerstone in every new business process needed in the world post-COVID, whether it's using Axon Citizen to gather evidence from the public or our prosecutor portal for sharing digital evidence with prosecutors and courts, the world is changing and Axon thrives on change.

We're even helping some key industry thought leadership group, replace their canceled conferences and move them online. Luckily, we have a bit of a reputation for being both innovative and pretty good at throwing great events. So we're loaning our expertise to industry partners to help them thrive in this new world with us.

Now, let's talk about the future. Our best estimates for the year remain unchanged and our pipeline remains strong. However, customers are relating to us that they're facing large budget shortfalls and uncertainty in the macro environment unlike anything any of us have ever seen. Currently, our sales pipeline remains solid. But we cannot see over the horizon any better than the rest of you to know how the economy will shake out or if the federal government will step in to provide additional aid to state and local governments.

Giving guidance implies a level of certainty that is simply not possible to ascertain right now. To be blunt, in an environment where we see so many companies acknowledging the uncertainties ahead by pulling formal guidance, we believe it would be most prudent to re-characterize our best estimates to acknowledge the higher than normal uncertainty. Hence, we're telling shareholders that even though our business has been very resilient to-date and our best estimates have not changed, the level of uncertainty has increased to a level where we're no longer comfortable characterizing those estimates as guidance until the macro environment stabilizes.

We don't want to imply that we know something the rest of the world doesn't, namely how the economy will unfold in the coming months. We do have Chief Revenue Officer, Josh Isner on the line. And during the Q&A, he can speak to the strength of our pipeline if you are interested. All that said, I couldn't be more bullish on Axon. We are change agents. Our adaptability and innovation-centric approaches are unique advantages for us when the world changes rapidly as is happening right now.

This isn't the first time Axon has faced adversity. Myself, our President, our Chief Revenue Officer were all together managing through the last recession from which we emerged far stronger. In 2008 as the financial crisis ripped the world, we decided to lean in and transform our entire business from being a simple TASER device manufacturing business into an integrated tech company making wearables and cloud software. That transition was anything than easy. And we've had many difficult learning curves to overcome.

But as competitors in the public safety space retreated, that's exactly when we advanced into new opportunities and we established ourselves as the clear market leader in cloud hosted digital evidence management, software and camera sensors. In the past year we've now shipped two major software products; Axon Records, which is now live or signed with in-flight deployments at more than a dozen agencies; and Axon Dispatch, which we just went live at our first customer.

Today Axon is stronger than ever, we ended Q1 with nearly \$400 million in cash and equivalents, zero debt and an underlying business that generates strong cash flow and high margin recurring revenues. Our Q1 revenue grew 27% year-over-year and while net income was affected by stock based compensation expense, our adjusted EBITDA more than doubled year-over-year to \$30 million, we're reflecting a 20% margin.

We have several moonshots in progress. Before this decade is out, we will launch a TASER weapon that will outperform a 9 millimeter pistol in stopping power. We will continue to make policing transparent and effective and we will extend our reach across the criminal justice system, making it both more fair and more efficient. We will continue to create great social value for society and great value for you, our shareholders.

And with that, I'd like to turn the call over to our President, Luke Larson. Luke?

Luke Larson

President, Axon Enterprise, Inc.

Thanks, Rick. Since COVID, as a leadership team we've been laser focused on three key priorities. Number one, the health and safety of our employees, number two doing our part to help flatten the curve and number three keeping key initiatives going to support our customers. I want to give a shout out to all of the Axon's employees, they've really stepped up the last two months. I want to give a specific shout out to Josh Goldman our VP of Ops; Elizabeth Hart, who heads up our people team and our entire IT team for their ability to shift our entire work force to work from home for all of our knowledge workers, as well as keeping critical mission lines open with CDC recommended guidelines.

These actions have allowed us to keep the business up and running to support our customers who are truly on the front line. Early on in the crisis, we began receiving messages from law enforcement around the globe, asking Axon if we will be shipping out TASER 7 and Axon Body 3. From major city police departments to small departments, many of our customers were anxiously awaiting to get their mission critical devices, making sure that our first responders have the tools that they need to keep communities safe was a key factor in our decision to keep mission critical manufacturing lines open.

To keep our employees health and safety and to do our part to flatten the curve, we added a lot of precautions and continued paying employees in high risk groups even though they couldn't work. We detailed that in our shareholder letter and it compressed our TASER gross margins by 110 basis points. If there were no COVID-19 beyond our phenomenal Q1 results that kicked off a strong start to the year, the secondary headline this quarter would be that Axon Dispatch went live. This is a major milestone for our company and shows Axon's ability to keep key initiatives going even throughout a global pandemic.

We told you last quarter that we would be live by mid-year with our first paying Dispatch customer and we're thrilled that we launched even a bit sooner. Dispatch is our entry into a \$2 billion rapidly growing real-time command and control software market. We're pretty thrilled to be powering the 911 dispatching operations for the city of Maricopa, which is our first launch partner.

This software is also critical to our mission to protect life. It empowers everyone involved in an incident response, dispatchers, call takers, command, patrol officers, firefighters and medical personnel. The goal here is to shorten the time from hello to hello. That's what the industry calls the time between when somebody first calls 911 to the time an officer arrives.

Another key initiative for us is hiring. And I couldn't be prouder of the hiring velocity that we've seen and we continue to accelerate particularly in this last quarter. As always leaning in rather than holding back. In particular, Chief Product Officer, Jeff Kunins, who's on the call with us today has rapidly filled key senior tech leadership roles including our new SVP of AI, VP of Digital Evidence Management and our GM of Axon Air, and more while doubling down to rapidly grow our engineering bench with bar raising talent in our global software hub in Seattle, as well as in Vietnam and Scottsdale.

I started out with a shot out to the Axon employees, and I want to end my section with another one. This is a great team that has really leaned in during the crisis to support each other, as well as our customers. Thank you to all of our dedicated employees. And with that I'll turn it over to our CFO, Jawad Ahsan.

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

Thanks, Luke. The world has changed since our last earnings call, and the challenges we face today are unprecedented. As I reflect on our Q1 results and take stock of where we stand today, three words come to mind; pride, resilience and confidence. We have made no secret of our love for our customers and I'm proud of the way we stepped up to source PPE for first responders in a nationwide campaign in partnership with the National Police Foundation.

I'm proud of the way our employees contributed to that campaign. I'm even more proud of the way that our employees adapted to our new reality continuing to work cohesively and productively even with a distributed workforce. It's a testament to the internal tools, systems and support infrastructure we've worked hard to put into place.

At this stage in our growth as an enterprise SaaS and connected device company, we have purposefully chosen to be aggressive with our investments and conservative with our balance sheet. This strategy has brought us the resilience that will allow us to weather this storm and emerge stronger than ever.

Our investments in both product and channel are yielding exciting returns and our liquidity position is exceptionally strong. We are also seeing three trends emerging that add to our resilience. First, the current crisis is fostering discussions about cloud software usage with agencies that wouldn't have previously considered it and

we're demonstrating the value and utility of Axon's citizen to agencies across the globe. Second, we're seeing more agencies move to Axon devices as standard issues rather than pooling or sharing devices. And third, we're seeing the federal government step in to bolster law enforcement budgets and committing stimulus to law and order spending which may have benefits that outlast the crisis.

Our go-to-market model is increasingly resilient as we sell more products that agencies pay for out of their operating budgets rather than being treated as an unpredictable capital expense. And the majority of our revenue is tied to bundled recurring contracts, 71% in 2019.

In our SaaS business, net revenue retention over the past six months has trended at about 120%. This has become an important metric for us in terms of how we look at the business and that is why we're sharing it today. The metric captures two key factors. First, our annual churn is almost nil as our customers typically sign 5 year to 10 year contracts, giving us more resilience in contracting than most other SaaS companies.

And second, Axon's retention rate captures that in any given year some portion of our agency customers are upgrading their contracts to take advantage of all of the new software tools we have to offer. Some major cities are committing to SaaS upgrades with Axon at 300% of their prior contracts, and that's a testament again to our resilience and to the value proposition we offer our customers.

Finally, as we look out at the remainder of the year, we are feeling confident. We are withdrawing our guidance today for one reason; the full extent and impact of the current crisis on the markets we serve and on our business, simply cannot be known at this time. What we do know is that we are evaluating a wide range of scenarios with respect to the potential ongoing impact of the pandemic and we feel confident in our ability to manage through this crisis.

In fact, our internal 2020 goals that we're managing to remain the same. In recent weeks, our federal and international pipelines have strengthened. We continue to hire bar raising tech talent at an accelerating pace and we continue executing upon a robust pipeline, closing large multimillion dollar, multi-year officer safety plan contracts.

These are uncertain times and our customers and employees are being impacted in significant ways. We're grateful to all of our employees around the world who continue to show incredible commitment to our mission, ingenuity and resolve in their execution. While we are facing unprecedented adversity today, one thing is for sure, our best days are still ahead of us.

With that, I'll turn it over to Andrea to take us through questions.

QUESTION AND ANSWER SECTION

Andrea James

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

A

Thanks, Jawad. Moderator, can you bring everybody up on to the camera view. Analysts, we want to see your pretty faces. Can you turn on your cameras? Okay. Our first question – thank you, our first question is from Scott Berg at Needham.

Douglas Sand

Media Arts Manager, Axon Enterprise, Inc.

A

Hey, Scott. Go ahead with your questions.

Scott Berg

Analyst, Needham & Co. LLC

Q

Hi, thanks. This is all different for Q&A. Hope everyone is doing well. Apologies, I was a couple of minutes late to the call, so if I ask you a redundant question I guess, you'll see that in my face at least. So I guess a couple questions. On the net revenue retention metrics that Jawad just gave at 120%, good metric. Thank you for disclosing it. Can you help us understand how that compares maybe over the last couple three years in terms of trending? Has that been around the 120%? Has it been up or has it been down? That would be helpful.

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yeah, Scott. It's been around that. It's one of the reasons that we've started to disclose it as that is, it's been stable enough over the past few quarters that we decided to start disclosing it, but it's something that we're very proud of.

Scott Berg

Analyst, Needham & Co. LLC

Q

Got it. And then from a follow-up question perspective, the inventory increased was something in pre-scripted remarks that kind of caught my eye at least is how high do you think inventory levels go over the next couple three quarters? I think it's a prudent move that you're doing obviously given the uncertainty around some of the global trade components there? But does that reach a really large level? And are you doing it because you've seen issues or are you just kind of protecting yourself from that opportunity?

Luke Larson

President, Axon Enterprise, Inc.

A

Hey Scott, great question. We have a big upgrade cycle ahead of us with TASER 7, as well as AB3 in addition to expanding in adjacent markets, corrections as well as international expansion. And so we went through an exhaustive exercise to say what is the right level of inventory for us to make sure that we can fulfill customer demand, de-risk our supply chain and also have enough for these expansions. That actually ended up being a great strategy and has helped us in the last few months. We're going through another analysis now to see what the right levels are throughout the year-end. We want to ensure that we're managing our free cash flow, but also have the right inventory level to support customer fulfillment.

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yeah. I want to add, Scott to that, just – so you know how to think about it from a financial perspective, it is going to be something that's going to be fairly material use of cash this year. We think it's the right thing to do for the reasons that Luke mentioned, but that's one of the advantages that we've got with the balance sheet that we have to be able to be in position to fund that inventory build.

Scott Berg

Analyst, Needham & Co. LLC

Q

Great. That's all I have. I'll jump back into the queue. Congrats, again.

Andrea James

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

A

Thanks so much guys. And we're going to take our next question from Charlie Anderson at Dougherty.

Charlie Lowell Anderson

Analyst, Dougherty & Co. LLC

Q

Great. Can you guys hear me, right?

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yeah.

Charlie Lowell Anderson

Analyst, Dougherty & Co. LLC

Q

Excellent. Well, congrats on a great strong start to the year. I wanted to – it sounds like just to characterize things, its sounds like you're not seeing the effects of COVID-19 as of yet on the pipeline of the demand profile. I want to make sure that that's correct, but you haven't seen any push outs or cancellations at this point, just wanted to sort of characterize what you're seeing real time as far as those conversations as cities are valued in the revenue?

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Hi, Charlie, that's a great question. Before I answer it, I'll come right back to it. I just want to acknowledge Breann Leath who is an officer out of Indianapolis Metro Police Department and we've been very active in supporting the department and her. She passed away in April due to a officer involved shooting and a very sad time for one of our longest standing customers and we just want to acknowledge her and her family.

We also want to acknowledge all of the first responders around the world, who didn't have the luxury of sheltering in place or quarantining, and are out on the frontlines putting themselves and their families at risk every day and we're here to support our customers and our thoughts and prayers are with them during this time.

Now, as it pertains to pipeline, it is accurate to say there have been some minor adjustments to the pipeline. We are hearing on a qualitative basis that some agencies do expect impacts on their budgets and there's tax revenues that are in question and so forth as well as federal support for state and local. On the flipside we're also hearing from some customers that COVID is the reason they're thinking about going to standard issue for our

product. So whether it's body cams or TASER, one way to limit contamination is not sharing equipment and we're hearing that sentiment as well.

And so I think there's a little on both sides here. So there's nothing material either way at this point that we view as a major disruption to the pipeline. But we do have respect for the unprecedented risk that exists right now with COVID. And so we're certainly focused on executing, fulfilling all of our goals this year and continuing to build our long-term pipeline not only in terms of state and local, but also federal, international and some of our newer channels as well. Thanks very much.

Andrea James

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

Charlie, do you have a follow-up. We can unmute his line.

A

Charlie Lowell Anderson

Analyst, Dougherty & Co. LLC

Yeah. Great. I do. Yeah. So thank you for all that color. So I guess I was also curious to as it relates to software, so on records and on dispatch I wonder if this presents potentially an opportunity for you guys as it relates to your pricing strategy relative to the incumbents there. So as you sort of consider the pressures that they may be under I'm sort of curious that gives you any opportunity that you're seeing? Yeah. So thanks.

Q

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

Yeah. To some extent certainly we view this as an opportunity. We continue to invest. We're investing in the channel and the product and we are using creative ways to continue to connect with our customers more virtually than ever. I think with or without COVID, we still feel like we are certainly a force to be reckoned with both on the product side and the channel side and any new product that we're investing in and bringing to market. And so we're definitely confident in the long term that we're going to be very, very competitive in all of these markets whether it's DEMS, CAD, RMS and so forth.

A

Charlie Lowell Anderson

Analyst, Dougherty & Co. LLC

Great. Thanks, guys.

Q

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

I want to add one thing there. I don't know that COVID is impacting so much. But I would say my confidence in our strategy and how we approach developing software products is getting stronger by the day and sort of the key element of that strategies, we decided not to try to go broad to win the battle of the RFPs with 800 check boxes. But to really build fantastic user centric software that does the things those officers do every day really, really well. And that allow us through our officer safety plan officers to try elements of the system and basically win through a fantastic user experience. And I think long-term that sets us up to have a really strong market position by focusing on the things that ultimately makes it a great experience for the cops in the field. And that strategy appears to be playing out as every time they're touching our software, we're hearing. Oh, wow, like this is a great experience and we have procurement plans that allow them to start small and expand with us.

A

Charlie Lowell Anderson

Analyst, Dougherty & Co. LLC

Thanks.

<A – [OJLVPJ-E]Andrea James – Axon Enterprise, Inc.> Okay. Your next question will come from Jonathan Ho at William Blair.

Jonathan Ho

Analyst, William Blair & Co. LLC

Hi. Can you hear me okay?

Andrea James

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

Yeah.

Jonathan Ho

Analyst, William Blair & Co. LLC

Perfect. One of the things I wanted to understand a little bit better is with the new CAD system that you're rolling out, can you talk a little bit about maybe the feature set and what segment of the market that you're potentially targeting since there's pretty much a high and mid-range and low end of the market, just want to get a sense of what you guys are looking at with that system?

Jeff Kunins

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

Yeah, absolutely. Great question. So first, the first thing I'd say is we're incredibly excited to be live in the market with our first happy customer in Maricopa, Chief Stahl. And by the end of 2020 just to put it in context, for this first year, our goal is to be GA with the product, that's a fantastic fit for a significant percentage of US agencies be alive, and/or in active deployments with the next handful of customers beyond Maricopa and be en route to steadily growing SAM coverage with strong sales pipeline from match.

And so, specifically, what that means for your question is, in the same way, that for records and RMS, kind of the unit of currency for building up coverage of which customers, for which you are a great fit for what's being in need which we're now well on our own journey and continuing to accelerate on.

For CAD, the main dimensions are one, whether given jurisdiction, key staff that serve the jurisdiction, only serves law enforcement dispatch or also serves fire and EMS, and then the second primary dimension is whether it's serving a single jurisdiction at a time where if it's an aggregated SaaS, that serves multiple jurisdictions at once. And so, what you'll see on here in the same kind of playbook we've been doing with records is starting with a whole great product for a subset of agencies that fit in one of those, just specifically like single jurisdiction law enforcement only and then will progressively from there becoming an awesome excessive tranche of potential customers. So that's our overall approach.

Of course, it's early days, I'm very confident to explain that over time, Axon will probably become the number one leader in both Record and Dispatch and that along the way we're going to wind up leveling the buying criteria for these categories to be much more about end-to-end agency productivity in the case of Record's and real time operations in the case of CAD.

So it's a multi-year journey, no one should have any illusions, it's going to be overnight, but just as Rick said, customers are loving what we're building, they're loving the OSP 7 Plus bundling approach and the way that makes things easier to buy and adopt and those two together are helping us stage where the puck is going.

Jonathan Ho

Analyst, William Blair & Co. LLC

Q

Fantastic. And just as a follow-up, with some of the potentially challenging macro environments that are coming up, how do you think about balancing between operating leverage and maybe investing when your competition cannot, any color there would be helpful? Thank you.

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yes. Jonathan, it's a great question, and that's something we actually very purposefully went into 2020 with our budget for the years. We had disclosed in our previous guidance that this is the year in which we're getting very aggressive about making investments in the R&D team and our product team in our sales channel, a lot of the open positions that we have are geared towards those groups as we're seeking to very aggressively to put pedal to the metal to try to continue to grow, bring these products to market, continue to expand our footprint and it's because of the proof points that we've seen in products like records in some of the international markets that we've started to enter is that we're going to double down on those bets.

Jonathan Ho

Analyst, William Blair & Co. LLC

Q

Thank you.

Andrea James

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

A

Our next question will come from Keith Housum at Northcoast Research.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Good morning, everybody. Hi. This question is for Josh. Josh, the international sales was very good this quarter. I was hoping you could provide a perspective. Is that more widespread across the Board or was it targeted with just a few different agencies? And then second was the strength in software and sensors or the weapons business, but some more color there?

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Yeah, sure. And thank you for the question, Keith. So I would characterize it as, look two years or three years ago, we made large investments in our international channel. We were seeing success at that point in Tier 1 markets, but outside of Tier 1, we're having very little success. And as we look at not only the Q1 results, but also the pipeline for the rest of the year, I'm feeling really good that that investment of a couple of years ago is really starting to pay off. And so while Q1 Tier 1 countries were strong in terms of revenue on the CEW side, we also saw some meaningful contributions from Tier 2 and rest of the world and I expect those to continue throughout 2020. I think especially on the CEW side, we're starting to see a lot of that work that the team has been putting in come into fruition.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Great. Thanks. And then just as a follow up Jawad, maybe if I could go back to a commentary I thought you guys said before. Was there a pressure of a 110 basis points on gross margins for I guess if I heard correctly you're paying for employees on the COVID time and is that going to continue on to the second quarter?

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yes. We're not going to disclose to what degree it's going to weigh on margins. But it is going to weigh on margins in Q2. This is one of the tricky things about not issuing guidance. We still are as I mentioned earlier managing to our internal estimates which would form the basis for our previous guidance. On the flipside, we're also seeing savings, right people aren't traveling as much. There are some programs that we had committed to that we're not going to be able to do in person. So now there's some cost savings that are associated with that, so while we are going to be impacted to a slightly larger degree in Q2 than what we saw in Q1. We also are going to see savings that are going to offset it.

Keith Housum

Analyst, Northcoast Research Partners LLC

Q

Great. Thank you.

Andrea James

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

A

Thanks Keith. We did come – question came in from the public anonymously actually. We weren't anticipating that, but it's a good one, so I thought I would answer it. It says, great earnings call experience, best one yet. Do you plan to continue providing earnings calls on Zoom instead of a traditional webcast?

I think our answer to that is design thinking, iterate test and learn, so we'll come back to you on that one. We'll see if you guys like it. All right.

So, our next question will be from Will Power at Baird.

William Verity Power

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

Q

Okay great. Yeah. A couple of questions, let me maybe start with the broader question for Rick or Luke or whoever wants to take it. One of the big themes in software particularly with respect to COVID-19 and the impacts is that as an accelerant to digital transformation more broadly, I wonder now what you're seeing with respect to the conversations you're having with law enforcement along those lines as you kind of talk about records, dispatch, trying to move to the cloud, that would seem to feed into that? Or is it just they're so focused in other things, that that's not really entering the dialog yet?

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

A

Yeah. Let me take this one. I mean there are some really bright silver linings to this that the cloud that is this pandemic. I talked about my customer engagement velocity. I literally I have never had this many customer meetings and I think their eyes have been open to new ways of interacting. I think that our traveling expenses

should be more controllable in the future, that we should be able to engage with more customers over Zoom. They're saying that this is an effective way to engage.

I'm also hearing and sensing two other things. One, another bright silver lining here is law enforcement is telling me that this has started to shift perceptions of police again where a few years ago, they were facing a lot of negativity. Now this is almost like a 9/11 sort of thing where people are realizing, hey, those cops are out there, more cops are being killed this year by the pandemic so far than guns and vehicle accidents combined. And that's a good thing that it's rebuilding public support for policing and we're hopeful that that will flow into the federal government actually stepping in and helping fund first responders.

And then the other side of it is, the impetus to do business differently is just strong. I was talking with some customers this past week, they want to start pushing the courts to start accepting digital evidence instead of forcing them burn things to disk, right, we've been successful in getting prosecutors to start using evidence.com, the courts have been more resistant to it where now people are downloading stuff at the prosecutor or the agency to put on discs to deliver to the court. And I've been out evangelizing this with our customers hey, bring, let's find the alpha patient, let's find some judges that are going to break down the barrier and say hey, look, let's move it online. And one of the things we hear is well courts don't have great like technology systems. That's music to our ears. They don't need it. They need a browser. They don't need to install servers and stuff. It's a fantastic opportunity for us to upgrade their experience and everywhere I look I see that the negatives of COVID are driving change that previously wasn't possible.

And I'll give you, one other example is, we with the push for Axon Citizen. In Europe, there has been just a ton of resistance in mainland Europe to using the cloud. For a whole bunch of reasons, we've talked about on previous calls and we've been really pushing the team hard to engage with customers. Look, what could be a stronger reason to move to a cloud hosted digital evidence sharing platform than social distancing in a world where you want to minimize the risk of your officers out going to pick up CDs and hard drives or thumb drives from the public?

I don't know that we have anything material to report back other than what we're hearing is quite different. Customers that have been traditionally quite resistant to change, they're changing across the board. And we're looking at how we can help use this to drive positive and long-term change, which can include a lot of digital transformation.

William Verity Power

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

Q

Okay. Yeah. All right. I guess, my second – oh go ahead.

Jeff Kunins

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

A

Go ahead, please.

William Verity Power

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

Q

I was going to say, my second question was just a follow-up on some of the corrections commentary. I know you all have been talking about that several calls in a row. I think you've referenced right in front of me maybe five states that you have relationships with now. Where does that stand in terms of shipments any other numbers, quantification, how long that takes to really kind of ramp into a bigger opportunity?

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Sure thing. So about a third into last year, we've ramped up our efforts specifically focusing on corrections. And this year, we have an independent sales team focused on that market. And I'm really excited about the work that they're doing so far. It wasn't a place where we were necessarily focused in the past, but now the use cases are coming up much more – becoming much more clear. And obviously on the body camera side, there are benefits there. And on the TASER side, in terms of riot control and so forth. And one of the interesting things is given COVID officers are actually really risking their safety by going hands on in jails because COVID obviously could spread really quickly through a contained environment like that. So we're seeing more investment in and a faster cadence than in the past particularly in the CEW segment to keep officers from having to go hands on and protect them from potential risk of infection. So long-term we definitely see corrections becoming a more meaningful part of our domestic business both on the federal and on the state and local level.

William Verity Power

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

Q

Okay. Thank you.

Andrea James

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

A

Thank you, Will. Our next question is from Joe Osha at JMP Securities.

Joseph Osha

Analyst, JMP Securities LLC

Q

Hi there. For starters, my compliments to everybody for doing such a good job with this Zoom conference. This has been great. Thank you to the IR team. Two questions. First, I see that the portion of TASER that was sold in a recurring payment plan went down as a result of the shift to International. I'm just wondering whether there might be some potential to think about shifting the way those non-US customers behaved over time? And then the second question is a more general one, we've had chain of evidence, we've had CAD, we've had records management. I'm just wondering whether this crisis might perhaps cause Axon to sort of resequence how it's coming at those priorities a little bit? Those are my questions.

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Okay, Joe. Thanks for the question, and I'd be happy to take the first one. And then, hand it over for the second one likely to Jeff. So on international subscriptions, we actually are seeing that already in our Tier 1 market. So in Australia, the UK and Canada, it is relatively common for agencies to sign up for a TASER 60 contracts where they pay just like in the US over 60 months, especially in the UK, every agency in the UK, that is a CEW customer is actually already on a TASER 60 plan. So the team has done a really nice job there, transitioning the subscription, Australia is moving in that direction as well. And then, Canada is lagging behind a little bit just due to the fact that we've commonly sold through distribution in Canada and the TASER 7 has not been authorized there yet.

And so, I would say that that ball is moving in the right direction. There is some complication in Tier 2 and 3 markets, especially some of the more volatile ones where there might be a little more risk of collectability on multi-year engagements and so forth. So we're monitoring that very closely to make sure that we're very confident in the deals we're signing. But I would say it's fair to expect international to continue to pivot more to subscription type of set up on TASER business.

Joseph Osha

Analyst, JMP Securities LLC

Thank you.

Q

Jeff Kunins

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

Yeah and continuing from now on the second part of question, obviously, we like to think of Axon as a learning and adapting machines. So we always continue to re-examine the data in front of us and reserve the right, so we've got smarter as we learn more. But I think from what we're seeing so far, our transformation has been validating of our focus and prioritization that we have in front of us. Our R&D investment which as you know, we've continued to double down on and be aggressive about investment, looking forward to leverage as we go forward.

A

Really our core pillars of de-escalation including TASER and sensors and signals and the like across our categories for cam and digital evidence management new investments and the categories productivity with records and communications and real time operations with CAD and those are taking up the vast bulk decision of some of these incubation areas like Axon Air with drones and the like and we evaluate those pretty regularly and we feel great about the validation we're seeing like what we've been describing with record and CAD and the rest that we've got the right positive attitude and investment in each of those and the right sequencing, but we'll continue to evaluate as we go and make those small and bigger adjustments if and when that makes sense. But we're feeling pretty good about that prioritization.

Joseph Osha

Analyst, JMP Securities LLC

Okay. Thank you.

Q

Andrea James

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

Thanks, Joe. Our next question is from Erik Lapinski at Morgan Stanley. Erik, your video is off, maybe another second...

A

Erik Lapinski

Analyst, Morgan Stanley & Co. LLC

Can you hear me? Hello?

Q

Andrea James

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

Yeah. We can hear you. Go ahead and ask the question. We can't see you. But go ahead and ask.

A

Erik Lapinski

Analyst, Morgan Stanley & Co. LLC

Sorry. It shows me online, but maybe I'll just kind of ask on dispatch and that first kind of key customer rollout, I mean from that from initial trials and interest and rollover of systems and final limitation like what were some of the learnings you maybe had on what the typical sales cycle would look like with a dispatch customer and anything you could share there?

Q

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

Sorry Eric, you were breaking up a little, do you mind just repeating that question. My apologies.

A

Erik Lapinski

Analyst, Morgan Stanley & Co. LLC

Oh yeah no problem. Can you hear me now?

Q

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

Yes.

A

Erik Lapinski

Analyst, Morgan Stanley & Co. LLC

So I guess just quickly on maybe what were some of the learnings you had from just the pace of rollout in the sales cycle with your first paid dispatch customer and kind of – I guess what you could share there?

Q

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

Sure thing. Thanks very much for the question. I think just like with all kind of early customers we're really focused right now on learning and so we have a pipeline of customers that we look forward to working with on cloud deployments. But the highest priority for us is gaining some early use cases, references and success stories. And so for the next at least three to five customers, that's really where our focus lies is making sure we're ready to scale and we continue to build that interest pipeline. So when that pipeline starts to converge, there are plenty of happy customers that can speak to their success with the product. We anticipate a lot of interest in the product from all segments in the market and we're seeing it already. And so, we're very, very excited about the potential of our CAD business.

A

Erik Lapinski

Analyst, Morgan Stanley & Co. LLC

That's helpful. And then if I could just maybe one follow-up. As you look at everything going on in the potential impacts that your customers could see like are there any actions or promotions you've thought through where you could kind of help customers I guess from a pricing or a pool license perspective or kind of accommodations you consider this year?

Q

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

Sure. Nothing really across the market. Certainly the customers that have voiced challenges whether their budget or timing of some of those budgets, we're working through them on a one – on kind of a one-off basis. But at this point, we don't plan on having like an overarching program across the market. Frankly, we just haven't seen that type of concern yet from a customer base. But certainly, we're going to continue to monitor it and where necessary, we'll make adjustments. But right now, we're still certainly executing as per our normal kind of approach to these deals.

A

Erik Lapinski

Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Luke Larson

President, Axon Enterprise, Inc.

A

Yeah. And I would just add on that we – today we have several different ways that a customer can acquire products from just buying an individual device in multiple plans or premium plan OSP 7 Plus and the leadership team is very aligned around the benefits of this as are the customers. They can just start using on day one. And so that's been very positively received.

Andrea James

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

A

Thank you guys. Erik and I can see you now. You popped up. So our next question will be from Ryan Sigdahl at Craig-Hallum. Go ahead, Ryan.

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Q

Hey thanks, Andrea. And to start I'm going to guess your background is fake.

Andrea James

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

A

Got it. Any others?

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Q

Oh. I'm going to guess Jeff.

Andrea James

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

A

So Jeff's background is actually the 14th floor at our Seattle Software Hub.

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Q

Okay. Well I'll take one out of two for some swag anyways.

Jeff Kunins

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

A

Come, visit anytime when we're open.

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Q

Awesome. First-off, just to follow-up on corrections, what percent approximately of the 450,000 correctional officers you think carry a taser today and then separately on the body cams?

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Yeah. Qualitatively both of those numbers are low relative to the overall population. But state by state, we're really making progress quarter-in and quarter-out to show some really rapid growth in that department. So at this point, I'm not prepared to give firm numbers on that, but qualitatively there's a lot of whitespace in that market and we think for the first time we're really seeing meaningful momentum there to start to capture some of that whitespace.

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Q

Fair to put it in a ballpark of 25%, 50%, 75%, just or innings that you want to talk baseball?

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Appreciate the sports analogy, but we're going to stick with the first answer on that one.

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Q

Okay.

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Natively very well. Thanks.

Ryan Sigdahl

Analyst, Craig-Hallum Capital Group LLC

Q

Second question, just on TASER 7, it declined for the second consecutive quarter. It seems a bit surprising given the recent launch. So how do you guys think about that product mix within weapons segments for the remainder of the year? Thanks.

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

So Ryan, thanks again for the question. I think that's just seasonality. Q3 and Q4 are strongest quarters of the year. So coming off our two strongest quarters with what historically have been kind of slower starts to the year in Q1 and Q2, it's not a huge surprise to us that TASER 7 sales are not going to be as strong here and we expect that to definitely change in the back half of the year as we continue to build pipeline and work with large agencies on meaningful T7 deployments.

Andrea James

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

A

Thanks, guys. Mike Latimore from Northland. You are up next.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Yeah, thanks. Can you hear me okay?

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

A

Yes.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Sounds good. Thanks. Yeah, I think you said that you have about 50% visibility into the kind of original guidance for the year. I guess at this point last year what was that visibility?

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yeah, in any given year Mike, we're typically into the year with about, I think last year was a little less, it was probably I think around the mid-40s I believe and this year, we have every year, as we continue to progress in our SaaS business, it's been increasing.

Andrea James

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

A

And Mike, you want to know what percentage, our Q1 sales make up the full year, it's a much higher percentage that would be typical this Q1.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Sure. Okay. Makes sense. And then I believe, in maybe third quarter, fourth quarter, you're going to start recognizing more of the records revenue, as different features get launched, what – and I think it's a little bit of a catch up event among customers that have already purchased the bundle. So like what kind of ARR maybe you get from them?

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yeah, well, the first thing is, we're actually not going to get to catch up the way the accounting works is that, we're going to take the same amount of revenue just over a compressed period of time. So it's going to step up pretty materially over the remainder of the – of those contracts, but there's not going to be a cumulative catch up as like in other long term contracts.

And right now, what we had said previously right now, we had – but we had said previously in our guidance that ARR was going to grow \$10 million per quarter. We felt it was conservative. This quarter it grew by \$12 million to \$13 million. And we think it's going to be in that \$10 million to \$15 million range. And as we get towards the end of the year, it's likely going to be at the top end of that range as more of our software products specifically Records and Dispatch come online.

Michael Latimore

Analyst, Northland Securities, Inc.

Q

Yeah. Yeah. And then you touched on this a little bit earlier, but in terms of just international cloud adoption as we won some of these additional deals internationally, how many are sort of willing to go with Evidence.com and the cloud? I mean, is that trending in the right direction?

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

A

Yes. I'd say it is trending in the right direction. I'd say everything in international and a huge credit to the team here and the team's leadership in each region. Things are generally trending in the right direction internationally

across video and CEW. Again, we're dealing with governments here not state and local governments like federal governments. So these deals do take longer to materialize. But we are seeing more interest in the cloud than we have in the past and more interest in CEW's than we have in the past.

Michael Latimore

Analyst, Northland Securities, Inc.

Okay. Thank you.

Q

Andrea James

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

Thank you.

A

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

Hey, Andrea. I'd like to reach out and thank Ryan for throwing his hat in the ring to guess on the special backgrounds. And so for analysts today who would through a hat in the ring in addition to the T-shirt swag, if you want to get yourself one of these fancy Axon tattoos, I'll pay for it personally because I want to encourage you all to get your best Axon swag on. So, Andrea, back to you for more questions.

A

Andrea James

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

Thanks, Rick. Actually to our buy-side investors on the call who have been e-mailing me. Thanks for guessing and it sounds like even some of our investors kids are getting in on it. So I just love that, like it's super cool. So thanks for e-mailing me to your guesses. I'll respond after the call. Okay, next question is from Scott Kessler at Imperial. Scott, go ahead and turn your video on for us.

A

Scott Kessler

Analyst, Imperial Capital

Hey, guys. I am hanging out outside. I unfortunately came unprepared don't have any questions so feel free to jump to the next person there.

Q

Andrea James

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

Oh, that's great. We have a 908 number dialed and I'm not sure who it is and I'm wondering if you'd like to ask a question.

A

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

While we're reading there Andrea, I want to take on the elephant in the room that maybe Scott was uncomfortable addressing and that is Josh Isner, can you share with folks what's going on with that epic beard, you've got going on. I'm sure folks seeing you after the first time with that, they want to know?

A

Joshua Isner

Chief Revenue Officer, Axon Enterprise, Inc.

Thanks, Rick for pointing that out. I really appreciate it. So yeah I made a commitment in early March that I would not shave or cut my hair until the office in Scottsdale reopen. At that time it looked like a late April, early May start,

A

Here we are on May 7th and it's been extended to June 1 and I am in a world of that hurt right now and my wife is even in a bigger world of hurt looking at me every day. So, thanks, Rick, I appreciate it, and hopefully the next time I see everybody, it'll will be slightly different look.

Andrea James

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

A

Okay. So if any other analysts have follow-ups, go ahead and let us know via the chat window. We have a few more minutes here. We did get some questions from the public. We hadn't planned on taking them, but I'll just read off a couple and we'll answer them if we have time. One is, is there a next generation of TASER 7 in development and if yes what would be some of its enhanced features. Rick, I think you should take that one.

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

A

Yeah. We typically don't talk about new features until they're launched. I would say we are – we're continuing evaluating some of the programmatic aspects of TASER 7 to make sure that we've got ways that it can fit all of our different bio-personas and kind of stay tuned as always for new product developments with Axon.

Jawad A. Ahsan

Chief Financial Officer, Axon Enterprise, Inc.

A

Yeah, I actually, I want to piggyback on this, because I know Rick is trying to do his best to not disclose too much, but one of the reasons I joined the company was to help Rick make the bullet obsolete. And the technology that we're working on now with the next generation TASER is going to be a big step in that direction. We laid out our goals toward the end of the decade, what we want to have accomplished in one of those is to have the TASER be the primary means for an officer to stop the threat. And I think that with what Rick in the TASER team have in mind and what they're working on is going to be a long way towards that.

Andrea James

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

A

Good. The next one, it's just an interesting question. Axon sells TASER self-defense devices into the consumer market, are there any plans to enter the consumer dash cam or body camera market?

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

A

Yeah, let me take that one. The answer is no. The consumer dash cam market is much more of a commodity market and the elements that make our system valuable for professional law enforcement users would not be particularly applicable in that market, so no.

Andrea James

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

A

Okay. Thank you. That's all we had time for from the public. Thanks for submitting your questions. I'm going to turn the call back over to Rick to close this out.

Patrick W. Smith

Chief Executive Officer & Founder, Axon Enterprise, Inc.

Awesome. Well, hey thanks. I'm really enjoying the positive feedback on the new format. It's been enjoyable for me to – I feel little more connected seeing your faces and interacting online. Sorry for harassing you a little bit

there, Josh. It just feels like this is a more human experience and nicer. We're going to evaluate and see if we keep doing it in June. I certainly found this to be much more engaging. I hope you did too.

I'd like to thank you all for joining us. As you know, Axon does not shy away from challenges. We view them as opportunities and we're trying new approaches and evangelizing our cloud software to public safety and increasing our productivity and we're going to continue to lean into everything that 2020 has got to throw at us. So we hope you all stay safe, healthy, and sane during this period of disruption and we look forward to updating you all again in August. So, thanks and we'll talk to you soon.

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