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AVAV - Q3 2020 AeroVironment Inc Earnings Call

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PRESENTATION

Steven A. Gitlin - *AeroVironment, Inc. - CMO & VP of IR*

Good afternoon, ladies and gentlemen, and welcome to AeroVironment's Third Quarter Fiscal Year 2020 Earnings Call. This is Steven Gitlin, Vice President of Investor Relations for AeroVironment. (Operator Instructions) As a reminder, this conference is being recorded for replay first. Before we begin, please note that on this call, certain information presented contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements and may contain words such as believe, anticipate, expect, estimate, intend, project, plan or words or phrases with similar meaning. Forward-looking statements are based on current expectations, forecasts and assumptions that involve risks and uncertainties, including, but not limited to, economic, competitive, governmental and technological factors outside of our control that may cause our business strategy or actual results to differ materially from the forward-looking statements. For further information on these risks, we encourage you to review the risk factors discussed in AeroVironment's periodic reports on Form 10-K and Form 10-Q filed with the SEC and the Form 8-K filed today with the SEC, along with the associated earnings release and safe harbor statement contained therein. This afternoon, we also filed a slide presentation with our earnings release and posted the presentation to our website at avinc.com in the Events and Presentations section.

The content of this conference call contains time-sensitive information that is accurate only as of today, March 3, 2020. The company undertakes no obligation to make any revision to any forward-looking statements contained in our remarks today or to update them to reflect the events or circumstances occurring after this conference call. Joining me today from AeroVironment are President and Chief Executive Officer, Mr. Wahid Nawabi; and Senior Vice President and Chief Financial Officer, Mr. Kevin McDonnell. We will now begin with remarks from Wahid Nawabi. Wahid?

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

Thank you, Steve, and welcome to our third quarter fiscal year 2020 earnings conference call. Today, I will refer to the supplemental investor presentation we filed with our earnings release and posted to our website. On today's call, I will discuss 3 key topics that are outlined on Slide #3 of our earnings presentation. First, we're on track to achieve our fiscal year 2020 objectives and deliver our third consecutive year of profitable double-digit growth. And today, we increased our EPS guidance to reflect our strong momentum. Second, we are well positioned to maintain our growth trajectory beyond fiscal year 2020 based on our assessment of demand drivers. And third, we're executing effectively against our strategy for long-term value creation and delivering significant value to our stockholders. I will start by summarizing our third quarter fiscal year 2020 performance while highlighting our key financial and operational achievements during the quarter. Next, Kevin McDonnell, our new Chief Financial Officer, will provide a more detailed summary of financial performance in the quarter. I will then discuss our goals and increased guidance for fiscal year 2020, before Kevin, Steve and I take your questions. As I stated last quarter, we expected about 1/3 of our second half revenue in the third quarter, which is consistent with the \$61.9 million we delivered and described on Slide #4. Third quarter revenue produced loss per diluted share of \$0.04 and non-GAAP loss per diluted share of \$0.01, which reflects expenses related to our Pulse Aerospace acquisition in June 2019, and amortization of intangible assets. Third quarter revenue also resulted in lower overhead absorption, which impacted quarterly earnings. Higher



revenue planned for the fourth quarter will result in improved absorption. For the fiscal year-to-date, revenue of \$232 million increased 3% compared to the prior year. This was a modest improvement that does not reflect the higher top line growth, we continue to expect for the full fiscal year 2020. Funded backlog of \$126 million declined from last quarter as a result of a contract awards timing. We expect funded backlog to increase with the finalization of multiple contract negotiations, which are currently underway. These contract negotiations include the multiyear Army LMAMS program estimated at \$160 million.

Now I will discuss the progress our team made in the third quarter. AeroVironment remains the go-to provider of fixed-wing Group 1 unmanned aircraft systems for the U.S. government and more than 45 allied nations. During the quarter, we announced international orders totaling \$18 million for 2 allied customers. Our international business remains strong heading into our fourth quarter. The recently released U.S. government fiscal year 2021 budget request includes \$85 million for LMAMS procurement and \$14 million from Marine Corps and Air Force Puma procurement. This results in a total of about \$100 million in requested line item funding for AeroVironment solutions. In addition to requested line items for our solutions, there is more than \$45 million for Marines and U.S. SOCOM unmanned requirements and \$40 million in requested funding for U.S. Army short-range reconnaissance or FRR and Soldier Borne Sensor or SBS programs. We believe these requested funding items represent additional potential opportunities for new next-generation AeroVironment solutions. And our family of tactical UAS, we are focused on developing this next-generation family of systems. These new solutions will offer an enhanced user experience and will be capable of operating with greater autonomy through our focused development projects in AI, computer vision and machine learning. Increased autonomy will reduce the cognitive load on system operators and will help enable operation in denied aerospace. We're making significant progress in this area and remain focused on delivering this next-generation family of systems.

Now turning to our Vapor small unmanned helicopter product line. We continue to execute our strategy and make good progress. We have relocated and set up Vapor manufacturing in Simi Valley and are now producing units alongside our other UAS and TMS products. Our Vapor systems are also generating interest from commercial customers who are pioneering the use of unmanned systems in their operations. Vapor is in the process of becoming evaluated for approval by the FAA for beyond visual line of sight operations in collaboration with a commercial customer. This specific timing is not known yet, but we look forward to achieving continued progress towards commercial certification. We're seeing continued momentum in our tactical missile systems product line, where we are the leading provider of loitering missile systems to the U.S. government with our Switchblade and its patent waveoff technology. We are in negotiations with our customer for the multiyear \$160 million LMAMS requirement. The timing of this contract award is currently uncertain, which means it could happen toward the end of this quarter or shortly thereafter. In addition to the U.S. government demand for our unique Switchblade capabilities, we are actively engaged in export discussions with multiple allied customers. We remain confident such exports will take place and create an opportunity for significant value creation, although timing is not certain. I would also like to point out that the \$85 million in the government fiscal year 2021 budget request for Army LMAMS includes \$5.5 million to promote competition for this program. Historically, every AeroVironment U.S. defense contract has required some form of competitive evaluation before an award could be issued. We have been competing successfully for more than a decade for LMAMS contracts and have had great success. These competitions typically involve a number of defense contractors in other companies, ranging from some of the largest in the world to very small startups. Consistent with our track record of competitive success, we are confident in our ability to compete and win future competitions. As a technology company, we continually invest in research and development to enhance our capabilities and solutions. Switchblade is an example of a product, we have continued to invest in to deliver the best capability to our customers and greatest value to our stockholders. Our investments to improve our operations continue to position us to deliver favorable bottom line results for our customers and our stockholders. As I have mentioned on prior earnings call, we continue to make progress in the development and maturation of a larger variant of our Switchblade solution. We continue to invest strategically alongside our customer in order to deliver this capability to the war fighter. During this fiscal year, we conducted a series of flight test which are moving us closer to introducing this product. This new variant is not only a game changer in this market, but it also significantly increases the size of the addressable market for our Switchblade family of systems.

We're excited about this opportunity to extend our leadership position.

Speaking of large markets, we continue to make progress on our HAPS program, which is targeting the global connectivity opportunity. We're preparing for the next round of flight testing, where we will expand flight duration and altitude while validating performance against our models. We now have 2 Hawk30 aircraft to deploy for flight testing. Last month, the HAPS alliance was unveiled to promote the growth of this emerging global industry, utilizing the stratosphere. Leaders from technology, telecom and aerospace industries joined the HAPSMobile Alliance to accelerate commercial adoption, advocate for safety and sensible regulations, promote cross-industry collaboration and provide thought leadership and



education. In addition to AeroVironment, SoftBank and HAPSMobile, the other participating companies include: Airbus, China Telecom, Deutsche Telekom, Ericsson and Telsa, Alphabet's Loon, Nokia and Telefonica. Broad and cross-industry support for the HAPS opportunity will help power its growth and create the framework for market adoption over time. This market and business opportunity are still in their infancy, but by working together with other industry leaders, we're confident we will advance the deployment of HAPS solutions for long-term value creation for AeroVironment stockholders and customers. With that as a summary of our third quarter, I'm delighted to introduce Kevin McDonnell as AeroVironment's Chief Financial Officer. Kevin brings extensive leadership and CFO experience across diverse industries, which give him unique insights and perspectives that will support AeroVironment's continued growth and success. Kevin is a strategic thinker with a demonstrated track record of long-term value creation, and we look forward to his contributions to AeroVironment's growth. Now Kevin will provide a detailed financial overview of our third quarter. Kevin?

Kevin Patrick McDonnell - AeroVironment, Inc. - Senior VP & CFO

Thank you, Wahid. Before sharing our third quarter financial results, I'd like to take a moment to thank AeroVironment's Board of Directors, Wahid, the leadership -- and the leadership team for the opportunity to serve our stakeholders as Chief Financial Officer. This is a unique and exciting company with tremendous growth potential. I look forward to working with our team to achieve our value creation objectives. I also look forward to meeting our stockholders and research analysts in the near future.

Now let's turn to the Q3 results, as highlighted on Page 4 of the posted presentation. Revenue for the third quarter of fiscal 2020 was \$61.9 million, a decrease of \$13.4 million or 18% from the third quarter of fiscal 2019 revenue of \$75.3 million. The decrease was due to a decrease in product deliveries of \$13.6 million. Third quarter fiscal 2020 revenue by major product line and program is as follows: small UAS was \$37 million or 60% of total revenue, HAPS was \$11.8 million or 19%, TMS was \$7.9 million or 13%, and other was \$5.3 million or 8%. Let me take a moment to outline the current status of the HAPS program. Inception-to-date revenue under contracts from the HAPS program is \$115 million. The total value of all contracts with HAPSMobile is \$148.6 million, which consists of \$140.3 million for design and development and an \$8.3 million for preliminary design and other related efforts. There is \$33.6 million remaining on these contracts, which includes a portion that is currently unfunded.

Turning back to the financial performance for the quarter. Gross margin for the third quarter of fiscal 2020 was \$23.5 million or 38% of revenue compared to \$30.4 million or 40% of revenue for the third quarter of fiscal 2019. The decrease in gross margin was primarily due to a decrease in product margin of \$7.8 million, partially offset by an increase in service margin of \$1 million. Gross margin as a percentage of revenue decreased to 38% from 40%, primarily due to a decrease in the proportion of product revenue to total revenue. As highlighted on Slide 5, product sales were 59% of total sales in the third quarter of fiscal 2020 compared to 66% for the third quarter of fiscal 2019.

In terms of bottom line results, the net loss from the third quarter of fiscal 2020 was \$1 million or \$0.04 per diluted share compared to net income of \$8.4 million or \$0.35 per diluted share for the third quarter of fiscal 2019. The reduced third quarter net income was a result of lower gross margin of \$6.9 million, higher operating expenses of \$2.1 million, increased loss from HAPSMobile equity method investment activity of \$0.5 million, and reduced other income of \$1 million. It should be noted that fiscal 2019 net other income included transition services income for services performed for the buyer of our former efficient energy systems business.

Non-GAAP diluted loss per share for the third quarter of fiscal 2020 was \$0.01 per diluted share and excludes \$0.03 per diluted share for intangible amortization expense and integration costs associated with our acquisition of Pulse Aerospace. GAAP and non-GAAP diluted earnings per share for the third quarter of fiscal 2019 was \$0.35.

Now moving through to our results for the first 3 quarters of fiscal 2020. Revenue for the first 3 quarters of fiscal 2020 was \$232.1 million, an increase of \$5.8 million from the \$226.3 million recognized in the first 3 quarters of fiscal 2019. The increase in revenue was due to an increase in product deliveries of \$7.3 million, partially offset by a decrease in contract service revenue of \$1.5 million. The first 3 quarters of fiscal 2020 revenue by major product line and program is as follows: small UAS was \$162.9 million or 70% of total revenue; HAPS was \$37.5 million or 16%; TMS was \$21.4 million or 9% and other was \$10.3 million or 5%. Gross margin for the first 3 quarters of fiscal 2020, was \$99.9 million or 43% of revenue as compared to \$91.4 million or 40% of revenue for the first 3 quarters of fiscal 2019. The increase in dollars was due to an increase in product margin of \$8.2 million and an increase in service margin of \$0.4 million. Gross margin as a percentage of revenue increased from 40% to 43%, primarily due to favorable product mix and an increase in the proportion of product revenue to total revenue. In terms of the year-to-date third quarter bottom line, net



income was \$23.6 million or \$0.98 per diluted share compared to \$41.8 million or \$1.49 per diluted share for the first 3 quarters of fiscal 2019. The fiscal 2019 year-to-date diluted earnings per share excludes income of \$0.25 per diluted share from discontinued operations.

In addition, the first 3 quarters of fiscal 2019 include a onetime gain from a litigation settlement equal to \$0.26 per diluted share, and net other income from transition services performed for the buyer of our former efficient energy systems business. In addition to above, fiscal 2020 net income decreased year-to-date as a result of increased operating expenses of \$11.4 million, increased loss from HAPSMobile equity method investment activity of \$1.3 million, partially offset by higher gross margin of \$8.6 million. I should also note that the effective tax rate was 10.6% for the first 3 quarters of fiscal 2020 compared to an effective income tax rate of 11.1% for the first 3 quarters of fiscal 2019. Non-GAAP diluted earnings per share for the first 3 quarters of fiscal 2020 was \$1.07 per share, and it excludes \$0.09 per share for intangible amortization expense, deal and integration costs associated with our acquisition of Pulse Aerospace. Non-GAAP diluted earnings per share for the first 3 quarters of fiscal 2019 was \$1.23 per share and excludes \$0.26 per share from a onetime litigation settlement gain in fiscal 2019.

Our funded backlog as of January 25, 2020, was \$126 million, a decrease of \$6.5 million from the third quarter of fiscal 2019 and a decrease of \$20.7 million from the second quarter of fiscal 2020 backlog of \$146.7 million.

Now I'd like to take a few moments to highlight some of the key balance sheet accounts. Cash, cash equivalents, restricted cash and investments at the end of the third quarter of fiscal 2020 totaled \$311.4 million, a decrease of \$21.2 million from the end of our fiscal -- from year-end fiscal 2019 balance of \$332.6 million. The decrease in cash was primarily related to our acquisition of Pulse Aerospace as well as our increased investment in the HAPSMobile joint venture. Net accounts receivable, including unbilled receivables and retention at the end of the third quarter of fiscal 2020, totaled \$105.3 million. Unbilled receivables and retentions was \$77.4 million, and this includes \$28.8 million of related party amounts, which we expect to be paid by the end of the current fiscal year. Total days outstanding from continuing operations for the third quarter of fiscal 2020 was approximately 151 days compared to 87 days for the fourth quarter of fiscal 2019. Net inventory at the end of the third quarter of fiscal 2020 was \$65.2 million compared to \$54.1 million at the end of fiscal 2019. The increase in inventory in Q3 reflects the buildup of inventory to fulfill a number of contracts like the Raven contract from the U.S. Army Security Force Assistance Brigades and the LMAMS contract. Days in inventory outstanding for the third quarter of fiscal 2020 was approximately 138 days compared to 92 days for the fourth quarter of fiscal 2019. In terms of capital expenditure activity in the third quarter of 2020, we invested approximately \$1.7 million in property improvements and capital equipment to support our growth and new product launches and recognized \$2.6 million of depreciation and amortization expense.

Lastly, I'd like to summarize our fiscal 2020 visibility, as highlighted on Page 8 of the supplemental charts. As of today, we have year-to-date revenue in fiscal 2020 of \$232 million. Third quarter ending backlog that we anticipate to execute of fiscal 2020 of \$95 million. Q4 quarter-to-date bookings that we anticipate to execute in fiscal 2020 of \$25 million. We currently have no unfunded backlog from incrementally funded contracts that we anticipate to recognize revenue during the balance of the year. This rounds to approximately \$350 million or 98% of our fiscal 2020 midpoint revenue guidance. We do anticipate a full year effective tax rate of approximately 11%. This is higher than the fiscal 2019 full year tax rate of 9%, primarily due to anticipated lower excess tax benefits from equity awards and other tax credits.

Now I'd like to turn the call back to Wahid.

Wahid Nawabi - AeroVironment, Inc. - CEO, President & Director

Thanks, Kevin. We're executing on our plan and are on track to achieve and exceed our fiscal year 2020 objectives and deliver a third consecutive year of profitable, double-digit top line growth. With 98% full year visibility to the midpoint of our revenue guidance range, as described on Slide #8, and a number of contract negotiations underway, we reiterate our guidance of \$350 million to \$370 million in revenue. As a result of anticipated favorable revenue mix and operational improvements, we are raising our earnings guidance as described on Slide #9. Our previous earnings guidance was between \$1.35 and \$1.55 in diluted EPS and between \$1.47 and \$1.67 in non-GAAP diluted EPS. Our new earnings guidance is between \$1.55 and \$1.75 in diluted EPS and between \$1.67 and \$1.87 in non-GAAP diluted EPS. This represents an increase of \$0.20 per share of earnings at the midpoint of the ranges. As I noted earlier, our investments are producing strong results and delivering favorable bottom line results for our customers and our stockholders. The midpoint of our fiscal year 2020 revenue guidance range implies fourth quarter revenue of \$128 million. While this is higher than each of our last 3 quarters, it is lower than we have delivered in the past. We are confident in our ability to achieve our targets and extend our track record of value creation. We continue to expect full year internal R&D spending to be about 11% of revenue.

Consistent with our plans, we are on track to invest 5% to 6% of revenue in capital expenditures this fiscal year to support our strong and consistent growth. We have summarized our full fiscal year 2020 financial expectations on Slide #9 of our supplemental presentation. Importantly, we are monitoring the coronavirus situation closely. Our business is not experiencing any adverse effects due to the virus at this time. Our supply chain is almost entirely U.S.-based. Safety remains a top priority for AeroVironment and out of abundance of caution, we're limiting some international travel by our people. Before we take your questions, I would like to reiterate our key takeaways from AeroVironment's third fiscal quarter. First, we are on track to achieve our fiscal year 2020 objectives and deliver a third consecutive year of profitable double-digit growth. And today, we increased our EPS guidance to reflect our strong momentum. Second, we're well positioned to maintain our growth trajectory beyond fiscal year 2020 based on our assessment of demand drivers. And third, we're executing effectively against our strategy for long-term value creation and delivering significant value to our stockholders. I would like to take this opportunity to thank our employees for their focus and dedication, our customers for continuously challenging us to deliver the most effective solutions to support their mission success, and you, our stockholders, for your confidence in our team and our plans. We are dedicated to helping you proceed with certainty. Kevin, Steve and I will now take your questions.

QUESTIONS AND ANSWERS

Steven A. Gitlin - AeroVironment, Inc. - CMO & VP of IR

Thank you, Wahid. (Operator Instructions) Our first question comes from Pete Skibitski at Alembic Global. Pete?

Peter John Skibitski - Alembic Global Advisors - Research Analyst

Wahid, can you tell us, are you leaning maybe towards the low end of your revenue guidance range at this point or the high end of the range? And maybe you could talk about what further moving pieces are within that range with 1 quarter left?

Wahid Nawabi - AeroVironment, Inc. - CEO, President & Director

Sure, Peter. So as I mentioned in my remarks, we delivered for the third quarter very closely to what we actually said during the second quarter earnings call, which I commented on. About 1/3 of our second half revenue will be in the first -- third quarter of the year. Secondly, we have looked at a number of opportunities that we have, and we're negotiating multiple contracts, both with domestic as well as international customers. As a result of that, based on the information that we have now, we believe that the guidance range on our revenue should remain at \$350 million to \$370 million, and we're confident about our ability to achieve that outcome. In terms of the EPS, GAAP EPS, we believe that based on improvements in our operations as well as a less favorable revenue mix that we see in this year that we increased our guidance by \$0.20, both on the GAAP as well as the non GAAP. So this will be, again, the third consecutive year of double-digit top line profitable growth. We're confident about our ability to achieve those targets. Should any change change, we'll keep you updated throughout the quarter and -- or otherwise, but next quarter call.

Peter John Skibitski - Alembic Global Advisors - Research Analyst

Okay. My follow-up on gross margins, in terms of your expectations for the fourth quarter. Your gross margins are obviously very strong in the first half of the year. They came down in the third quarter, I think, sort of as expected. How are we thinking about the fourth quarter? Should that be a sequential increase from the third quarter? Would it compare to the first half? Just any color there would be appreciated.

Wahid Nawabi - AeroVironment, Inc. - CEO, President & Director

Sure. So as I stated in the remarks, we only guide on the top line revenue and on our bottom line, GAAP and non-GAAP EPS. And we -- based on the revenue mix, you're absolutely correct that Q3, we expected this, primarily because of the timing of the contracts, lower volume as well as the revenue mix of products versus services and with the type of contracts that we had for the third quarter. That's only optically for the third quarter. For the full year, we're confident with the EPS guidance at both on the GAAP and non-GAAP, and we believe that, that's the reason why we raised



it. Obviously, if you look at the full year number, that would most likely indicate slightly higher gross margin percentages for the fourth quarter to achieve the full year results based on our R&D spending and as well as our revenue and EPS guidance.

Steven A. Gitlin - *AeroVironment, Inc. - CMO & VP of IR*

Thank you, Pete. And our next question comes from Ken Herbert of Canaccord Genuity. Ken?

Kenneth George Herbert - *Canaccord Genuity Corp., Research Division - MD and Senior Aerospace & Defense Analyst*

. Wahid and Steve and I welcome, Kevin.

Kevin Patrick McDonnell - *AeroVironment, Inc. - Senior VP & CFO*

Thank you.

Kenneth George Herbert - *Canaccord Genuity Corp., Research Division - MD and Senior Aerospace & Defense Analyst*

Wahid, I just wanted to first ask on the LMAMS and the contract, it sounds like there's still some -- maybe some uncertainty around timing. Can you just maybe provide a little bit more color or handicap the potential to see that in that contract finalized in fiscal '20? Or if it slips into fiscal '21 when you'd expect it? Maybe just some of the moving pieces between what you're seeing now and wrapping that up?

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

Sure. So Ken, as I mentioned on the remarks, and as you stated, yes, we're very much in the thick of the negotiations on that contract. Obviously, this is the largest contract, a multiyear contract in the history of our TMS business. So it's a significant contract for us. We're making significantly good progress in -- although the process of negotiating and definitizing such a contract does take quite a long time. We expect this contract to either close towards the end of this fiscal year or the beginning of next. So really, it's a optics timing situation, if you ask me. Regardless of that, we believe that based on a portfolio of opportunities that we have, that we are confident with our ability to achieve our revenue guidance for the full year as well as the increased EPS guidance range that we provide for the full year. So we look at a number of different factors and contracts and opportunities to determine the range of outcomes that we believe is most likely for the quarter at this time.

Kenneth George Herbert - *Canaccord Genuity Corp., Research Division - MD and Senior Aerospace & Defense Analyst*

Okay. And if I could, just to follow-up on your -- the larger Switchblade variant, you've talked about this call. You've indicated, I think, that you view this as a larger addressable market. Can you provide any more detail, Wahid, on maybe when you'd expect to be getting some of these under contract? Maybe your target market or any other detail on this opportunity for a larger Switchblade, which sounds fairly interesting?

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

Sure. No problem, Ken. So yes, of course, we -- as we introduce the initial Switchblade that we've been now providing to the U.S. military on open competitions for over a decade successfully and essentially, one, almost every single competition and contract that has been competitive, open competition in our entire history. I wanted to make sure that I'd clarify that to our investors and our shareholders and our analysts. Number two, we are in the midst of the development of a larger variant of our original Switchblade. This larger variant, obviously, flies further and longer and carries a much bigger mission effects or mission impact. And so what that does, it actually increases the addressable size of the market for Switchblade and tactical missile systems significantly. We have conducted already successfully a series of flight tests, which is part of the development effort. And we're looking forward to introducing this product to the market in the near future. And as we make more progress, and we're ready to introduce

it, we'll obviously update you at that time. But it's a very exciting capability, which we're co-funding alongside our customer to deliver -- and develop and deliver the next-generation of capabilities for the warfighter that they need, and it's very exciting for us.

Steven A. Gitlin - *AeroVironment, Inc. - CMO & VP of IR*

Thank you, Ken. Our next question comes from Troy Jensen at Piper Jaffrey. Troy?

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

Congratulations on the nice results and the better profitability.

Kevin Patrick McDonnell - *AeroVironment, Inc. - Senior VP & CFO*

Thank you.

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

Thank you, Troy.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

So first, a clarification, did you say that the HAPS segment was \$7.9 million?

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

The HAPS segment, I believe that Kevin mentioned on his remarks.

Kevin Patrick McDonnell - *AeroVironment, Inc. - Senior VP & CFO*

You know, the HAPS revenue...

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

Revenue segment, yes.

Kevin Patrick McDonnell - *AeroVironment, Inc. - Senior VP & CFO*

It was \$11.8 million.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

It was \$11.8 million, so TMS was \$7.9 million.



Kevin Patrick McDonnell - AeroVironment, Inc. - Senior VP & CFO

Yes.

Troy Donavon Jensen - Piper Sandler & Co., Research Division - MD and Senior Research Analyst

All right, all right, perfect. All right. So then the question is, I would just love to know more about just the next -- the timing of these next test flights for HAPS and the milestones we'd be -- should be looking for? And then a follow-up to that would be, if you look at the HAPS Alliance, it seems like there's a few international carriers listed there, Deutch Telecom, China Telco and I think Telefónica, but just curious on U.S. service provider interested in HAPS partnerships?

Wahid Nawabi - AeroVironment, Inc. - CEO, President & Director

Sure. So in terms of the flight testing for HAPS, as you know, we're under the -- what we refer to the design, development and demonstration agreement, which essentially means that we have to develop the airplane, design it, provide or make and produce 2 airplanes and deliver those 2 to our customer being HAPSMobile joint venture, and as part of that, we also have to achieve a certain milestones of flights, et cetera, et cetera. We are coming towards the near-end of that phase of this multiphase business plan, Troy. And we currently are preparing for multiple -- a series of flight tests, which essentially what it does, it increases the flight envelope, both in terms of duration of flight as well as altitude of where, we're going to be flying this airplane higher and higher. And our goal, obviously, is to achieve all of those successfully and then it's not a binary sort of a situation. We're going to transition essentially from design and development to testing and certification of the airplane, which is another phase of this development effort. That is where we are with the flight, and we're very pleased with our results so far, and we're making significant progress in this area, and we believe that this represents a very significant long-term opportunity. In terms of your second question, the HAPS Alliance. Yes, the HAPS Alliance is a very major, what I call, step towards the adoption and opening of the stratosphere for 5G connectivity. The HAPS Alliance, essentially, the initial 3 partners that formed it was AeroVironment, SoftBank Telecom of Japan as well as Alphabet's Loon. And essentially, now since we launched this already, we have multiple global companies, both from telecom as well as technology and other industries have joined this movement, and the intent here is to essentially bring forward this topic of how do we harness the stratosphere, and how do we make Global 5G connectivity, able and realistically capable with the HAPS platform. That is the main intent of that HAPS Alliance. We're very pleased that multiple parties from around the world actually is joining us in this endeavor, and has already become members of this alliance, and we look forward to progressing our efforts and bringing this vision to reality 1 day.

Steven A. Gitlin - AeroVironment, Inc. - CMO & VP of IR

Thank you, Troy. (Operator Instructions) Our next question comes from Louie DiPalma at William Blair.

Louie DiPalma - William Blair & Company L.L.C., Research Division - Analyst

[First] 1 for Kevin. Is the difference between the bottom and the top range of the 2020 revenue guidance related to the \$160 million LMAMS contract? And are those shipments expected to start before the end of April?

Kevin Patrick McDonnell - AeroVironment, Inc. - Senior VP & CFO

Yes. I think Wahid would address that earlier. Basically, we have a range of opportunities and different possibilities. So we've, obviously, taken that into account as we look either to sign that this year or early next year.



Wahid Nawabi - AeroVironment, Inc. - CEO, President & Director

Yes. So we -- Louie, we expect to achieve our range by a number of different opportunities, neither 1 of 1 specific 1 is the make or break situation for us. And we look at all the different variables and different factors, and we determine what's the most likely range of outcomes that we believe at this time. And since our expectation on that contract is, it could happen at the end of this fiscal year or may not, in terms of it's definitizing. We believe it's going to happen either close to the end of this quarter or the beginning of next quarter. But at either case, we are still confident about our ability to achieve our guidance range, and that's why we confirm the top line, and we increased the bottom line by 20%, which essentially makes the third consecutive year of us delivering double-digit top line profitable growth as part of our process here.

Louie DiPalma - William Blair & Company L.L.C., Research Division - Analyst

Sounds good. And Wahid -- you noted that you have successfully competed against many large contractors for LMAMS over the past 8 or so years. Do you feel that the budget request, which may not actually come to fruition, but the budget request that seeks a second source for LMAMS? Do you think the reason that they put that in there was to achieve the benefits of diversity? Or do you think that the customer just wants to keep you on your toes?

Wahid Nawabi - AeroVironment, Inc. - CEO, President & Director

So let me answer the question very clearly, based on where we see it, Louie. I'm glad you asked that question. First and foremost, historically, every single competition and award that we have received for the LMAMS and other UAS products, of course, with the U.S. DoD, we have competed on those. Open competitions with not just 1 but multiple parties competing, both small and large companies. DoD -- defense contract as a whole of nondefense startup companies from the technology world. And you could see from our track record over the last decade plus that we've had a significantly strong track record. Almost -- I am not familiar, aware of any losses that we've had in this space at all, to my knowledge, to our knowledge, number one. Number two, when the budget documents are formed, they usually are formed and developed, way in advance of today, probably months and months in advance. Usually, the Pentagon has to include specific dollars for different allocations of purposes or items. And there is a \$5.5 million or \$5 million, which I mentioned on the call earlier in my remark, allocated for -- essentially, I think it says to qualify a second competitor or a contractor. We're very familiar with that. We also are very familiar with the fact that this has happened in the past, and we have competed very successfully. And last but not least, I mentioned that, that the contract that we're under negotiation right now extends our ability to deliver solutions to our customer for at least another 3 years. So that's a 3-year contract. So one could argue that this has really tried to position for beyond that, and we are used to that, and we look forward to that competition, and we absolutely are focused on making sure that we win as we've won in the past. And again, this to us is a very positive because this is a growth opportunity for us. We've developed this capability. We have patented technologies that are within our Switchblade and tactical missile systems, such as our wave off capability, which is very unique to this loitering munition systems. And we believe that we hold a compelling differentiation in our solution against all competitors globally in this space, and we welcome the competition.

Steven A. Gitlin - AeroVironment, Inc. - CMO & VP of IR

Thank you, Louie. Our next question comes from, once again, Peter Skibitski at Alembic Global. Pete? Pete are you with us?

Peter John Skibitski - Alembic Global Advisors - Research Analyst

Yes. I'm sorry, Can you hear me?

Steven A. Gitlin - AeroVironment, Inc. - CMO & VP of IR

Yes, we can. Pete.

Peter John Skibitski - *Alembic Global Advisors - Research Analyst*

Sorry about that. A couple of follow-ups. First 1 is just a housekeeping question. Do you guys have what the international revenue was for the quarter?

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

We're going to look that up for you right now, Peter, just a second.

Peter John Skibitski - *Alembic Global Advisors - Research Analyst*

Okay, great. Well, maybe I'll ask the second 1 while you guys look that up. Second 1 was on the larger Switchblade variant. I'm trying to figure out, I guess, get a better sense of the funding for that, because kind of looking through the Army's budget, you see the LMAMS funding, I don't see anything in there right now for sort of a larger Switchblade variant in terms of production. So maybe I'm missing it, but do you guys sense that this larger Switchblade variant that its production run is funded? Or are you hopeful that it will be added to the budget maybe in fiscal '22 and beyond?

Wahid Nawabi - *AeroVironment, Inc. - CEO, President & Director*

Sure. So we have a co-funding customer that is funding this with us together. And our customer and us believe that -- we've always believed that there was a family of loitering munition and the future strategy of our tactical missile systems business and product line. We've always believed that from the inception of when we launched the first product to the market. So what is exciting about this one is that because it flies further and carries a bigger mission effect, obviously, a larger payload. And it also has a longer endurance in terms of its flat duration, it opens up the envelope of missions far beyond our current original Switchblade capability. If you look at the DoD spend and other category of systems that are in that space, it's much, much larger spend dollars in that addressable market. So we have been co-investing in this with our customer, and I'm very pleased that the progress we made so far is incredibly great. We've had a series of flight tests, and we've successfully achieved those. We continue to do that, obviously, with a mission critical, lethal loitering munition, safety and reliabilities of utmost importance for the war fighter and our customer, and we take nothing for granted. And so we're doing -- we're going through a series of testing, and we hope that we could introduce this product to the market in the near future. And when we are ready, obviously, we'll tell you that. In terms of funding, this is a new capability, just like our Switchblade, as you remember. When we first introduced that product, there was nothing like it in the market. And we believe that this is the case with us as well. And so obviously, we have to work with our customers to educate them and inform them about this capability, so they can essentially switch their acquisition dollars or generate new acquisition dollars for the consumption of this in the long term. And obviously, that's 1 of the reasons why we invested in this alongside our customer for the long-term growth and value creation strategy.

Kevin Patrick McDonnell - *AeroVironment, Inc. - Senior VP & CFO*

And to answer your first question, the international revenue in the third quarter was \$34.3 million.

Steven A. Gitlin - *AeroVironment, Inc. - CMO & VP of IR*

Thank you, Pete. At this time, we have no further questions. We thank you for your attention and for your interest in AeroVironment. An archived version of this call, all SEC filings and relevant company and industry news can be found on our website, www.avinc.com. We wish you a good day, and we look forward to speaking with you again following next quarter's results. Thank you.

Operator

And thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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