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AXON ENTERPRISE EQUITY REPORT

FEBRUARY 5TH, 2020

AXON SUMMARY

BY THE NUMBERS

TICKER: AAXN

PRICE: \$81.79



Axon Enterprise Inc. develops, manufactures, and sells conducted energy weapons (CEWs) worldwide. The company operates through two segments:

1. TASER
2. Software and Sensors

The company was formerly known as TASER International, Inc. and changed its name to Axon Enterprise, Inc. in April 2017. Axon Enterprise, Inc. was founded in 1993 and is headquartered in Scottsdale, Arizona.

N/A

DIVIDEND YIELD

+62%

Y/Y RETURN

\$4.9B

MARKET CAP

ANALYSIS

Axon (AAXN) is a market-leading provider of law enforcement technology solutions. On top of the two areas they specialize in the company also provides:

1. Axon Body, on-officer body cameras
2. Axon Fleet in-car video systems
3. Axon Evidence connected software network
4. Axon Records cloud-based records management system
5. Axon Signal enabled devices and computer-aided dispatch software
6. Axon docks, cartridges, and batteries
7. Evidence.com, a cloud-based digital evidence management system

Axon is a volatile stock that tends to move big on news whenever police brutality is brought into question and making headlines in the news. This is simply because AAXN offers "less lethal" means and is promoting the use of video and data recording to ensure all parties know exactly what has occurred during these events. In fact, their slogan is "Protect Life".

We must first question if there is truth to this statement and analyze some data. For example, in February, Reuters published a piece documenting more than 1,000 deaths after the use of a Taser since its introduction 20 years ago, and there's no evidence that police use of the device led to a reduction in the use of firearms, or reduction in use of force.

Reuters contacted 14 police departments, counties and cities that saw a Taser-related death or other serious Taser-related incident in 2018 (there were 49 people who died after being tased in the United States). Of those, five are reviewing their Taser policies; three had conducted reviews and made no changes; and five declined comment because investigations into the incidents were still ongoing.

Also, how often do police officers even use their guns? About three-in-ten adults estimate that police fire their weapons a few times a year while on duty, and 83% estimate that the typical officer has fired his or her service weapon at least once in their careers, outside of firearms training or on a gun range, according to a recent Pew Research Center national survey.

This is actually not the case. Only about a 27% of all officers say they have ever fired their service weapon while on the job, according to a separate Pew Research Center survey conducted by the National Police Research Platform. The survey was conducted May 19-Aug. 14, 2016, among a nationally representative sample of 7,917 sworn officers working in 54 police and sheriff's departments with 100 or more officers.

Furthermore, about one-in-five officers (22%) in areas with at least six, but fewer than 10, violent crimes per 1,000 residents in 2015 have ever fired their service weapon. By contrast, about a third (32%) of officers who work in areas with a lower violent crime rate have discharged their gun. In areas where the violent crime rate is 10 or more, 28% of officers have fired their weapon. However, that proportion is not significantly different from the share that works in communities with fewer than six or six to fewer than 10 violent crimes per 1,000 residents.

In addition, not all demographic characteristics are equally good predictors of gun use. Gender is one of the best, the analysis finds. Male officers are more than twice as likely as female officers to have fired their weapon (30% vs. 11%). Female officer growth in the force has been stagnant at around 13% of the workforce, only up 3% since the 1970s. This happens to work in Axon's favor as men are more inclined to use their firearms.

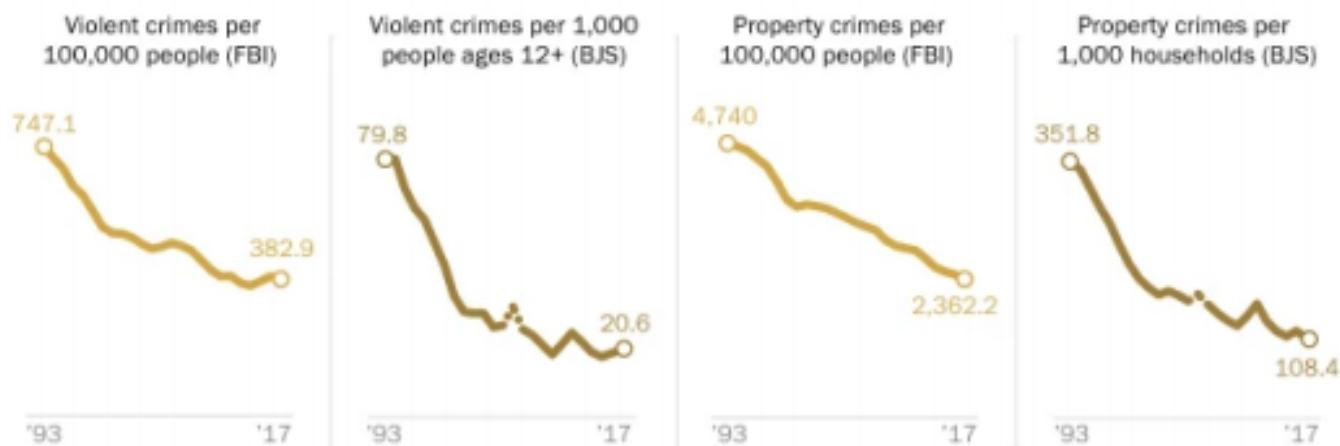
Lastly, white officers also are more likely than officers who are racial or ethnic minorities to have fired their weapon (31% vs. 21%). In 2013, the percentage of police officers who were members of racial or ethnic minority groups (black or African American, Asian, Native Hawaiian, Pacific Islander, American Indian or Alaska Native, and persons of Hispanic or Latino origin) was nearly double that of the late 1980s, the Bureau of Justice Statistics reported. Racial or ethnic minorities accounted for 27% of local police officers in 2013, a slight increase from 25% in 2007 and up from about 15% in 1987. Put simply, the police force is growing more diverse and, based on statistics, are less likely to use their firearms.

Why bring up this data? It's important to understand the current police environment when analyzing a company whose main revenues come from Tasers and body cameras. What we can tell right now is that police don't use their weapons as much as the general public thinks, tasers may not be as safe as we think they are, minority growth in the police force should lead to less gun use if history is any indicator.

While this is all great, CUBE thinks this mainly comes down to PERCEPTION.

Crime rates have fallen since the early 1990s

Trends in U.S. violent crime and property crime, 1993-2017



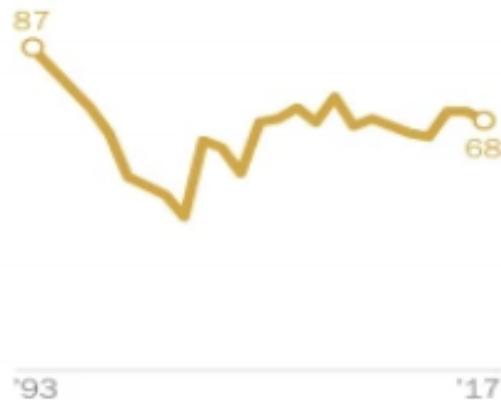
Note: FBI figures include reported crimes only. Bureau of Justice Statistics (BJS) figures include unreported and reported crimes. 2006 BJS estimates are not comparable to those in other years due to methodological changes.

Source: FBI, Bureau of Justice Statistics.

PEW RESEARCH CENTER

Public perception of crime rate at odds with data

% saying there is more crime in the U.S. than a year ago



Violent crimes per 1,000 people ages 12 and older



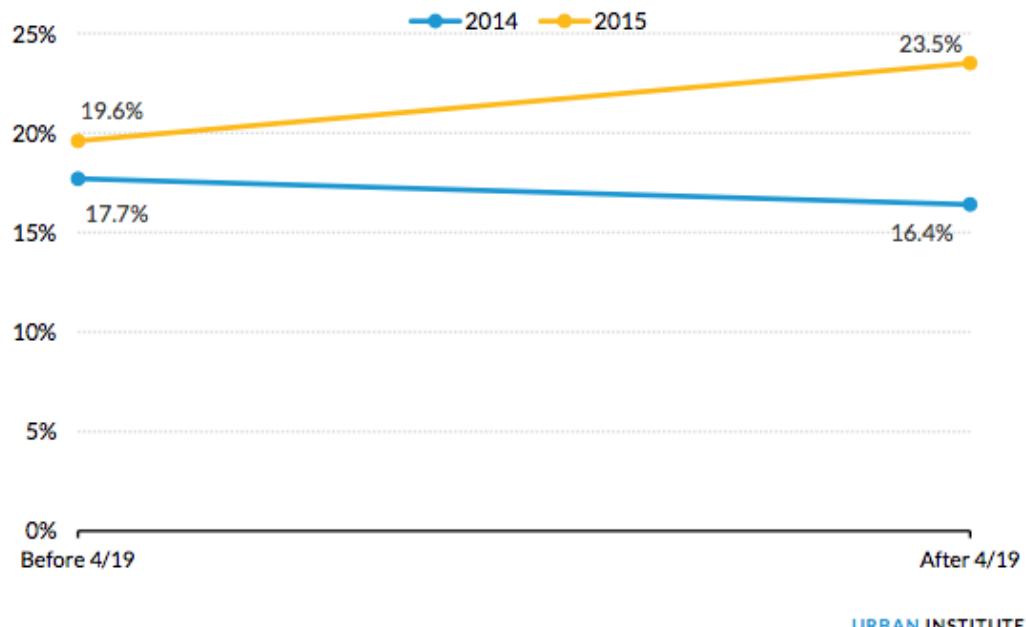
Note: 2006 Bureau of Justice Statistics (BJS) estimates are not comparable to those in other years due to methodological changes. To allow for comparisons across the same time period, 2018 public opinion data not shown.

Source: Gallup, Bureau of Justice Statistics.

PEW RESEARCH CENTER

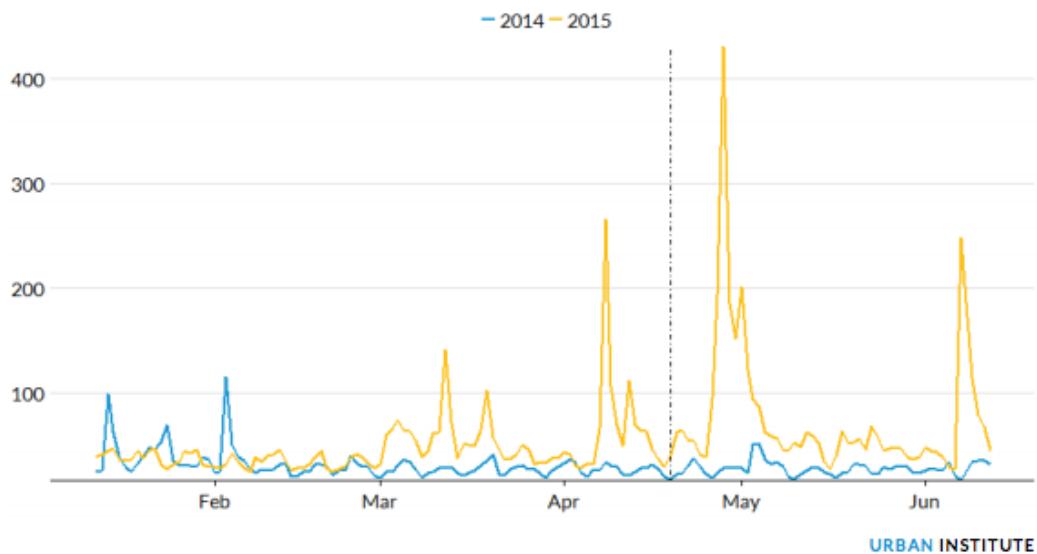
Statistics are important, make no mistake, but perception is reality and with the increase use of social media we are looking at a completely different story. The more negative news about police brutality the more municipalities will push for alternatives to guns and more cameras EVEN if the stats tell us there is far less crime today.

Average Daily Percentage of Tweets about Police that are Negative



Source: Authors' analysis of Twitter data for January 12–June 12, 2014, and January 12–June 12, 2015.

Total Daily Negative Tweets about Police
In thousands



Source: Authors' analysis of Twitter data for January 12–June 12, 2014, and January 12–June 12, 2015.

Note: Dotted vertical line marks the day of Freddie Gray's death in 2015.

The images above show how much more people are inclined to take to social media in a negative tone before and after a gun related event and how people believe there is more crime today when there isn't. On the above page, these stats were conducted by the Urban Institute, in which they acquired more than 65 million public tweets that include the words "police" or "cop" from a Twitter data provider.

Here were the results:

Sentiment of Tweets about Police

Sentiment	Frequency	Percentage of all tweets
Positive	1,323,142	2.0
Negative	13,344,742	19.4
Neutral	38,247,598	58.9
Not applicable	11,859,964	19.6
Total	64,775,446	100.0

Source: Authors' analysis of Twitter data for January 12–June 12, 2014, and January 12–June 12, 2015.

Note: Table shows sentiment of tweets that mention "police" or "cop" over the 2014 and 2015 periods mentioned above.

Only a mere 2.0% tweeted about the police in a positive light, while over 19% was negative. CUBE would argue it actually doesn't even matter. The more the police is a topic of conversation, the more Axon will be thought of as an alternative to gun violence and brutality.

Put simply, while stats may not conclude that tasers and body cams are indeed helpful to "Protecting Life", the surge in social media on the topics of police has pushed municipalities and governments to adopt the technologies. One last example proves this, around the same time of this study the White House created \$263 million in funding for police body cameras and training in the wake of the shooting death of unarmed 18-year-old Michael Brown. The program offered a total of \$75 million over three years to match state funding for the cameras by 50%, helping to pay for more than 50,000 of the devices.

Moving along, Axon doesn't have too much competition in the conducted electrical weapon (CEW) space. There is a company that is interesting that could pick up steam though as an alternative that we must mention. Granted, CUBE believes its more of a niche but the product is called the Bolawrap and it's made by Wrap Technologies (WRTC).

[Click this to see a video](#) of how the product works. It's like a new-age lasso. This is something that municipalities are beginning to consider. We think its a super neat device after watching several videos and just wanted to put this out there as a potential competitor to AXON even though its not a CEW.



CUBE'S TOP PROS FOR AAXN



REVENUE
GROWTH



TRANSITION
TO SOFTWARE



LITTLE
COMPETITION

CUBE'S TOP CONS FOR AAXN



RELIANCE ON
GOVERNMENT
BUDGETS



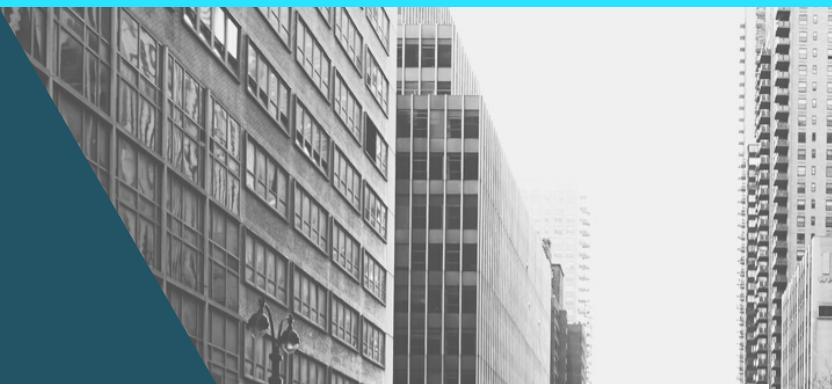
VALUATION



MARGINS

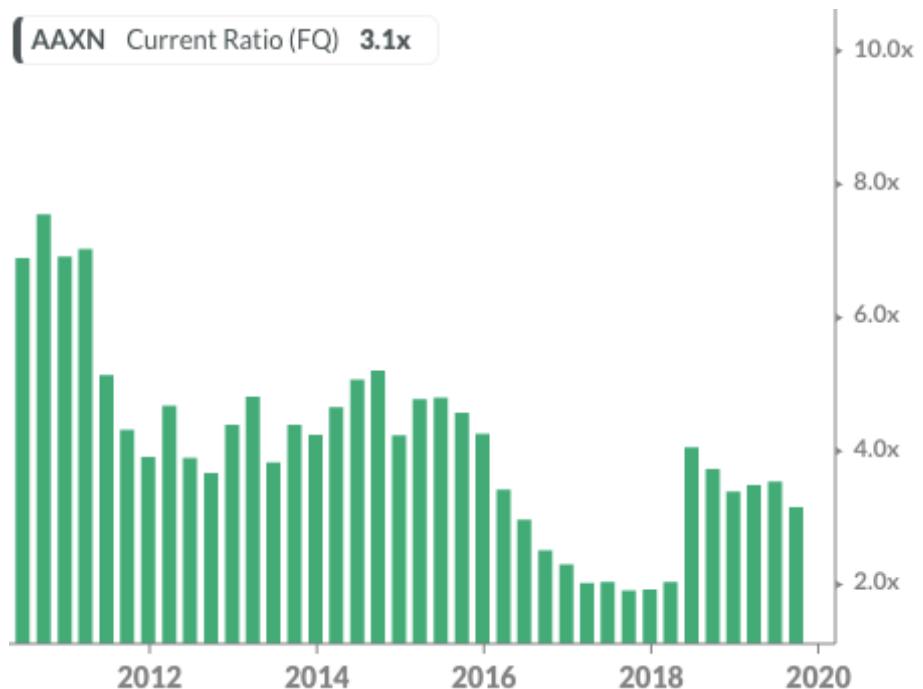
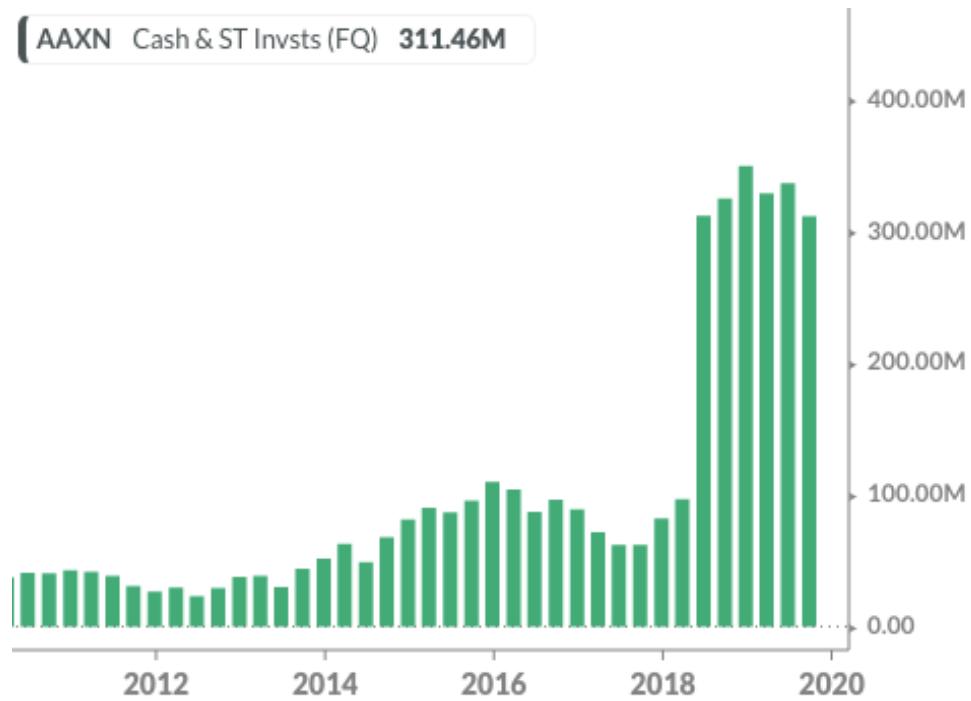
FINANCIAL STATEMENTS

BALANCE SHEET



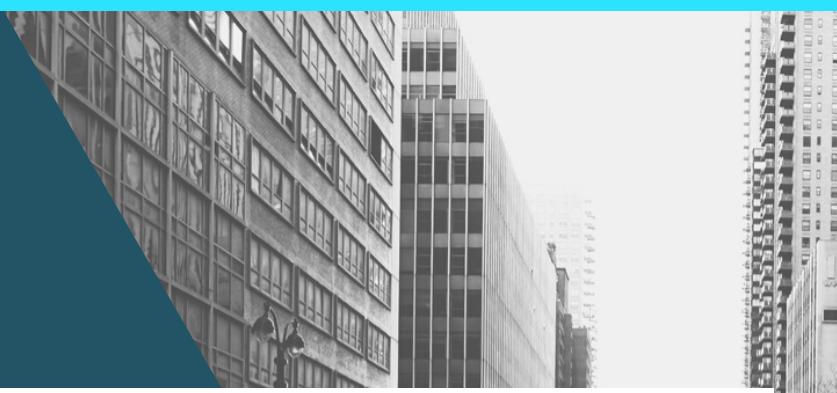
	September 30, 2019	December 31, 2018		
	(Unaudited)			
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 202,551	\$ 349,462		
Short-term investments	108,913	—		
Accounts and notes receivable, net of allowance of \$1,983 and \$1,882 as of September 30, 2019 and December 31, 2018, respectively	149,013	130,579		
Contract assets, net	33,602	13,960		
Inventory	40,666	33,763		
Prepaid expenses and other current assets	41,277	30,391		
Total current assets	576,022	558,155		
Property and equipment, net of accumulated depreciation of \$38,470 and \$39,885 as of September 30, 2019 and December 31, 2018, respectively	42,592	37,893		
Deferred income tax assets, net	23,290	19,347		
Intangible assets, net	13,528	15,935		
Goodwill	24,876	24,981		
Long-term investments	41,391	—		
Long-term notes receivable, net of current portion	33,463	40,230		
Other assets	37,142	22,999		
Total assets	\$ 792,304	\$ 719,540		
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	\$ 14,638	\$ 15,164		
Accrued liabilities	35,745	41,092		
Current portion of deferred revenue	127,160	107,016		
Customer deposits	2,294	2,702		
Other current liabilities	3,997	37		
Total current liabilities	183,834	166,011		
Deferred revenue, net of current portion	82,149	74,417		
Liability for unrecognized tax benefits	3,443	2,849		
Long-term deferred compensation	3,694	3,235		
Other long-term liabilities	11,537	5,704		
Total liabilities	284,657	252,216		
Commitments and contingencies (Note 12)				
Stockholders' equity:				
Preferred stock, \$0.00001 par value; 25,000,000 shares authorized; no shares issued and outstanding as of September 30, 2019 and December 31, 2018	—	—		
Common stock, \$0.00001 par value; 200,000,000 shares authorized; 59,320,793 and 58,810,637 shares issued and outstanding as of September 30, 2019 and December 31, 2018, respectively	1	1		
Additional paid-in capital	480,747	453,400		
Treasury stock at cost, 20,220,227 shares as of September 30, 2019 and December 31, 2018	(155,947)	(155,947)		
Retained earnings	184,644	171,383		
Accumulated other comprehensive loss	(1,798)	(1,513)		
Total stockholders' equity	507,647	467,324		

When we look at AAXN's balance sheet everything looks pretty solid. The company is sitting on nearly \$202M in cash and \$108.9M in short-term investments with no debt, healthy accounts receivable, healthy inventory, and enough cash to cover all liabilities - both short and long-term.



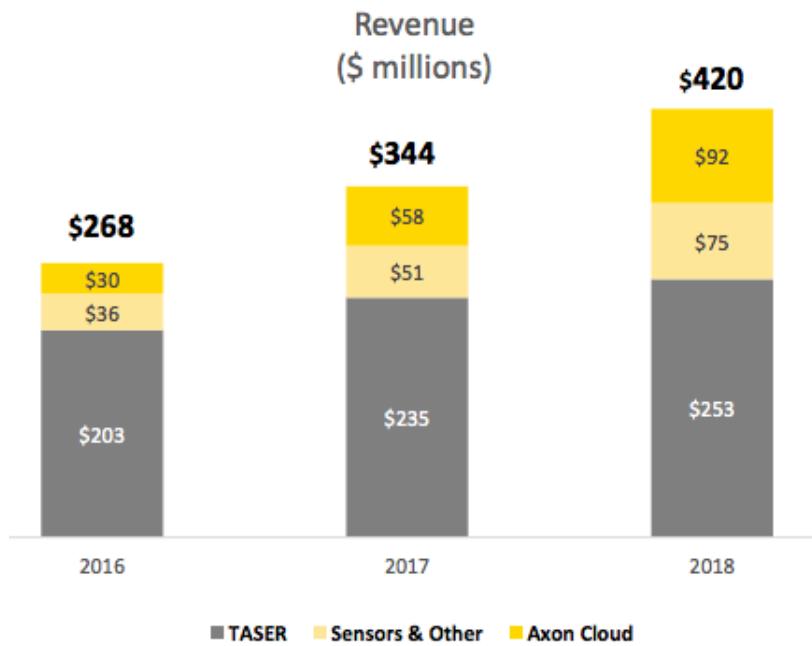
FINANCIAL STATEMENTS

INCOME STATEMENT



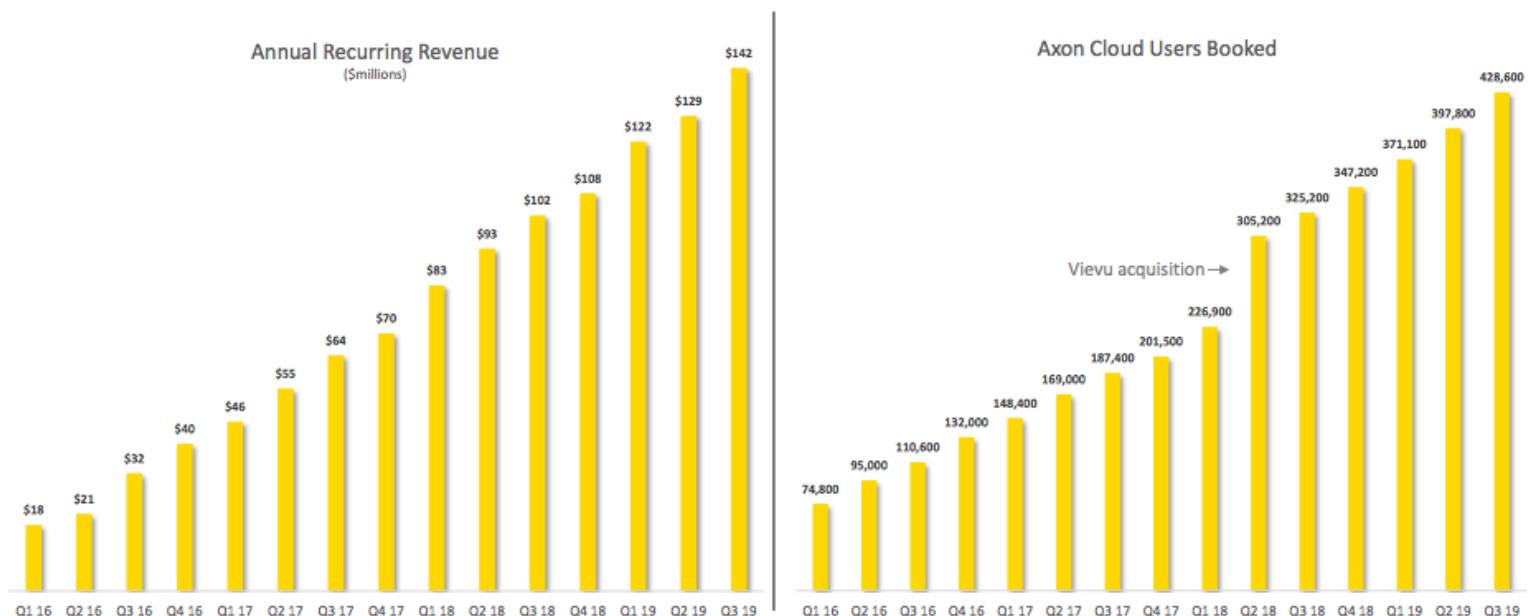
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net sales from products	\$ 96,497	\$ 80,923	\$ 264,977	\$ 238,618
Net sales from services	34,340	23,913	94,032	66,659
Net sales	130,837	104,836	359,009	305,277
Cost of product sales	42,445	32,953	120,265	96,474
Cost of service sales	8,223	6,250	24,098	15,566
Cost of sales	50,668	39,203	144,363	112,040
Gross margin	80,169	65,633	214,646	193,237
Operating expenses:				
Sales, general and administrative	48,424	39,685	134,678	114,787
Research and development	25,129	21,982	71,976	55,602
Total operating expenses	73,553	61,667	206,654	170,389
Income from operations	6,616	3,966	7,992	22,848
Interest and other income (expense), net	1,820	1,274	5,978	2,242
Income before provision for income taxes	8,436	5,240	13,970	25,090
Provision for (benefit from) income taxes	2,332	(471)	709	(2,032)
Net income	\$ 6,104	\$ 5,711	\$ 13,261	\$ 27,122
Net income per common and common equivalent shares:				
Basic	\$ 0.10	\$ 0.10	\$ 0.22	\$ 0.49
Diluted	\$ 0.10	\$ 0.10	\$ 0.22	\$ 0.47
Weighted average number of common and common equivalent shares outstanding:				
Basic	59,278	58,340	59,128	55,681
Diluted	60,059	59,805	59,938	57,254

What we like the most about Axon is that they are transitioning to a software and data play. This is more than often the preferred route as the company is now focusing on the full value chain for the industry from record management to cloud services which will allow them to increase their addressable market and also grow margins.



As we can see in 2016, Taser revenues made up 76% of revs, in 2017 it made up 68% of revs, in 2018 it made up 60% of revs.

Axon has not released their FY19 results yet but through Q3, Taser revs make up 55% of revs.



On top of this, software and sensor growth stands at nearly 38% YTD vs. Taser sales growth of 5.3%. Investors will be looking for continued growth in software and sensors to keep the stock rolling higher.

	Nine Months Ended September 30, 2019			Nine Months Ended September 30, 2018		
	TASER	Software and Sensors	Total	TASER	Software and Sensors	Total
TASER 7	\$ 39,466	\$ —	\$ 39,466	\$ 52,618	\$ —	\$ —
TASER X26P	37,832	—	37,832	52,618	—	52,618
TASER X2	40,413	—	40,413	62,686	—	62,686
TASER Pulse and Bolt	2,920	—	2,920	3,849	—	3,849
Single cartridges	57,354	—	57,354	51,763	—	51,763
Axon Body	—	18,820	18,820	—	15,082	15,082
Axon Flex	—	4,517	4,517	—	4,529	4,529
Axon Fleet	—	10,977	10,977	—	6,640	6,640
Axon Dock	—	9,401	9,401	—	7,332	7,332
Axon Evidence and cloud services	363	93,461	93,824	—	64,513	64,513
TASER Cam	—	2,481	2,481	—	2,839	2,839
Extended warranties	13,341	14,064	27,405	11,567	8,521	20,088
Other	6,017	7,582	13,599	5,331	8,007	13,338
Total	<u>\$ 197,706</u>	<u>\$ 161,303</u>	<u>\$ 359,009</u>	<u>\$ 187,814</u>	<u>\$ 117,463</u>	<u>\$ 305,277</u>

To provide more clarity on their Q3 results:

- Revenue of \$131M represented 25% Y/Y growth
- Gross margin of 61.3% increased from 58.3% in Q2 2019
- GAAP EPS was \$0.10; Non-GAAP EPS of \$0.28
- Adjusted EBITDA was a record \$24M
- Cash and investments grew \$16.5M sequentially to approximately \$353M
- TASER gross margin of 63.1% increased sequentially from 59.9% in Q2 2019.
- 42% Y/Y growth in Axon Cloud revenue to \$34M
- Axon Cloud gross margin of 75.8%
- Sensors and Other revenue, which largely consists of product hardware, grew 45% Y/Y to \$25M
- Sensors and Other gross margin of 36.4%

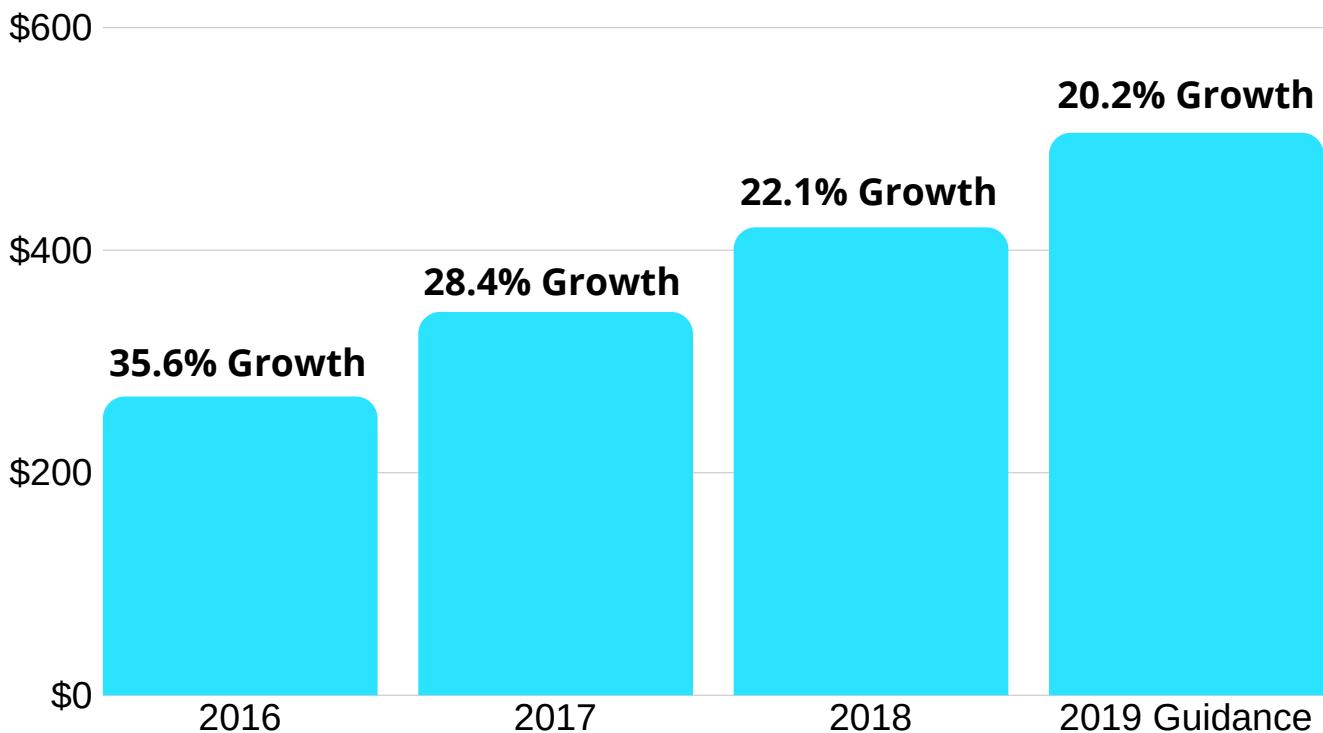
It's the Axon Cloud that investors are keeping a super close eye on due to its superior growth and margins. As this continues to grow and makes up a larger portion of revenues, the stock will be able to command a higher revenue and earnings multiple.



GUILTY PLEAS UP 20%³
**OFFICER COURT TIME
REDUCED BY 70%⁴**

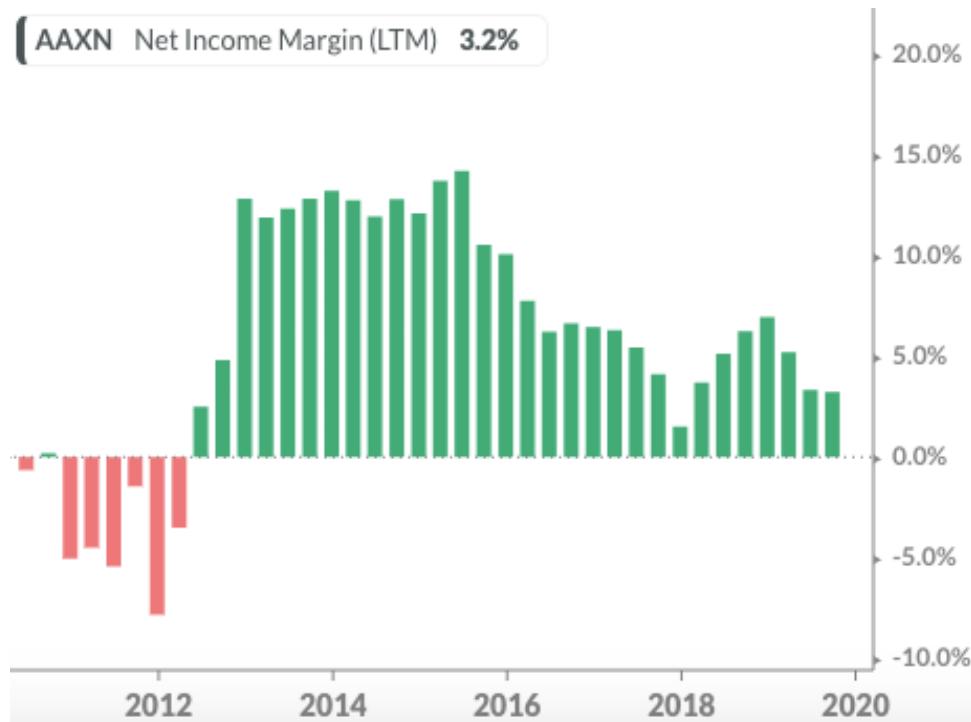
Outlook

- Raised annual revenue outlook range to \$500M-\$510M, from \$485M-\$495M
- Reiterated expectations for annual adjusted EBITDA of \$80M-\$85M



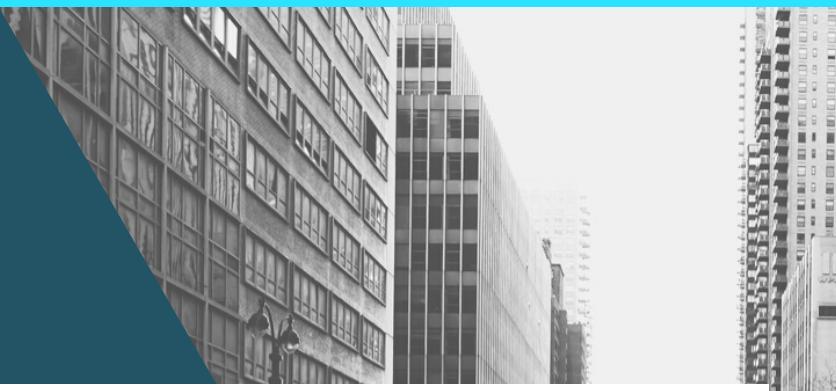
Year-to-date, profitability has taken a hit as the company has seen sales, general, and admin costs rise \$20M Y/Y alongside an increase of \$16M in R&D, up 29% Y/Y. As you can see below, AAXN has been investing much heavier into research and development and this shouldn't necessarily be frowned upon. The company is creating many new products and is also building out their software platform.

What this has done though is put a strain on net income margins as seen in the bottom image of only 3.2% profit margin.



FINANCIAL STATEMENTS

CASH FLOW



	Nine Months Ended September 30,	
	2019	2018
Cash flows from operating activities:		
Net income	\$ 13,261	\$ 27,122
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,196	8,226
Loss on disposal and impairment of property and equipment, net	2,408	290
Loss on disposal and abandonment of intangible assets	51	2,103
Stock-based compensation	30,195	15,302
Deferred income taxes	(3,946)	(2,326)
Unrecognized tax benefits	594	99
Other noncash, net	2,923	34
Change in assets and liabilities:		
Accounts and notes receivable and contract assets	(30,497)	(51,172)
Inventory	(6,302)	9,033
Prepaid expenses and other assets	(11,967)	(12,081)
Accounts payable, accrued and other liabilities	(13,528)	4,306
Deferred revenue	28,476	31,700
Net cash provided by operating activities	<u>19,864</u>	<u>32,636</u>
Cash flows from investing activities:		
Purchases of investments	(242,693)	(4,331)
Proceeds from maturity/call of investments	92,207	10,658
Purchases of property and equipment	(12,111)	(6,880)
Purchases of intangible assets	(328)	(460)
Business acquisitions	—	(4,990)
Net cash used in investing activities	<u>(162,925)</u>	<u>(6,003)</u>
Cash flows from financing activities:		
Net proceeds from equity offering	—	233,993
Proceeds from options exercised	106	713
Income and payroll tax payments for net-settled stock awards	(3,268)	(11,973)
Payment of contingent consideration for a business acquisition	—	(575)
Net cash provided by (used in) financing activities	<u>(3,162)</u>	<u>222,158</u>
Effect of exchange rate changes on cash, cash equivalents and restricted cash		
Net increase (decrease) in cash, cash equivalents and restricted cash	<u>(678)</u>	<u>(381)</u>
Cash, cash equivalents and restricted cash, beginning of period	351,027	78,438
Cash, cash equivalents and restricted cash, end of period	<u>\$ 204,126</u>	<u>\$ 326,848</u>

AAXN is cash flow positive but as mentioned previously their decrease in net income has effected their cash flow for the year. YTD, operating cash flow is down from \$32.6M to \$19.8M.

The investing cash flows look a lot worse than they really are. AAXN decided to use a large portion of cash to place into short-term investments so that's what that is. While cash itself is down from \$326M to \$204M on the bottom of the cash flow, we have to remember that AAXN also has \$108M in short-term investments which are highly liquid. This puts their liquidity around \$312M which is slightly below 2018s level.

Based on what we see, a dividend does not look probable anytime in the near future as AAXN also isn't buying shares either. They are focusing on investing in growth.

SOME OTHER KEY STATS

Quick Ratio

2.7x

(Cash + Marketable Securities + Accounts Receivable) / Current Liabilities

EBITDA Margins

7.7%

Earnings before interest, taxes, depreciation, and amortization

Return on Assets

1.13%

Return on Assets (ROA) is an indicator of how well a company utilizes its assets, by determining how profitable a company is relative to its total assets.

Short Interest %

14%

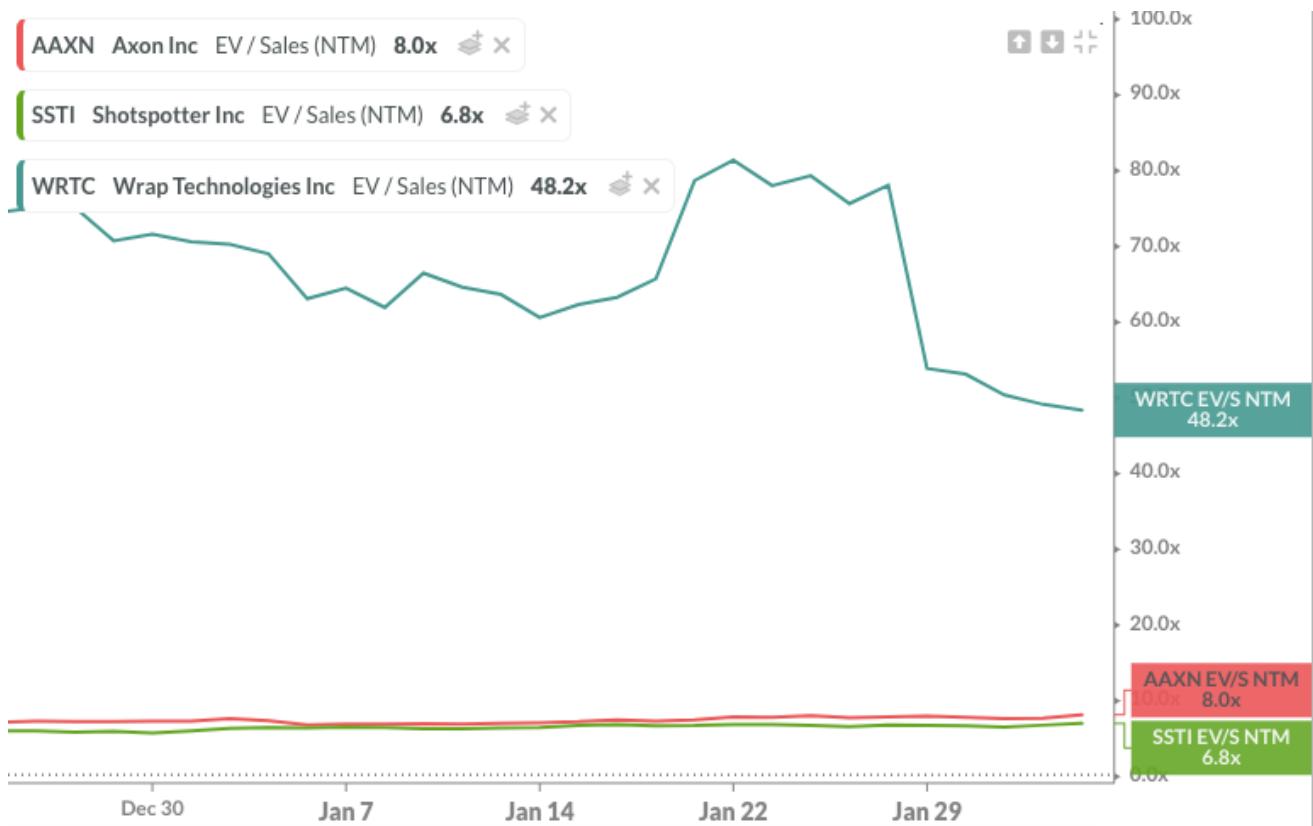
Amount of shares outstanding that are currently shorted



AAXN FUNDAMENTALS

There aren't too many companies to compare to Axon but we are going to go with Wrap Technologies (WRTC), the makers of the Bolawrap, and ShotSpotter (SSTI), a software-as-a-service based gunshot detection solutions company. We have actually done research on Shotspotter, you can [view that here](#). Not to brag, but that stock was called to the point.

From an immediate Enterprise Value/Sales ratio, we see that AAXN trades at 8.0x while SSTI trades at 6.8x. WRTC which is still getting its revenues underway trades at a far higher level of 48x.





AAXN FUNDAMENTALS

On an EV/EBITDA basis, WRTC doesn't draw in any positive EBITDA so they are excluded from this calculation. AAXN trades at a fairly high 41.7x while SSTI is around 28.5x. Both of these companies have come down a ton in this regard when compared to 2018.





AAXN FUNDAMENTALS

On a P/E basis, AAXN is around 64x while SSTI struggles a little more with profitability and trades close to 155x. Both of these ratios are pretty high especially for companies that will most likely generate only double digit revenue growth next year.





AAXN

TECH ANALYSIS





TECH ANALYSIS SUMMARY

Looking at the charts, we believe AAXN is due for a pullback to the \$75-76 range as the company was unable to break past and hold the R1 resistance line of \$82.40 today.

Furthermore, the stock is now overbought on the W%R and nearly overbought on the RSI and MFI. On top of this, the stock is pushing hard against the upper bollinger band which will also serve as a resistance level.

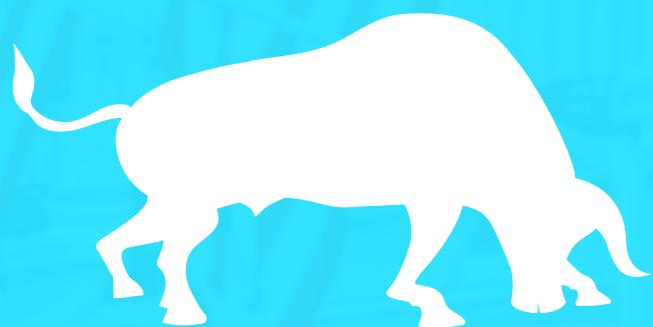


We expect solid support in the \$75 range as the 20DMA is \$75.38 and the pivot point is \$75.25. If these two levels still can't hold, it will most likely visit the 50DMA of \$73.84 which has served as a pretty good support level.

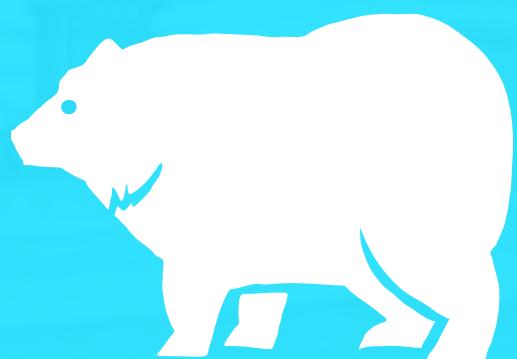
To the upside, if the stock can, in fact, close above the R1 level of \$82.40, there is a good chance it moves to the upper BB of \$83.40.

BULLISH OR BEARISH?

.....



VS.



**MORE BULLISH
(POSITIVE)**



**MORE BEARISH
(NEGATIVE)**



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AAXN CONCLUSION

Overall, CUBE is neutral (hold) on Axon (AAXN). We like the fact that the company has little competition and is transitioning to become a more integrated software company but we believe at 20% revenue growth and below average margins, the stock trades at a pretty fair valuation of 8.0x forward sales.

If the company was a full-on cloud and software play with tech margins, this would still be considered a fair valuation with the revenue growth but that simply isn't the case. Their hardware sales still make up a majority of revenues and we believe this will eventually become a minority sometime in 2020/2021 but the company will still have inferior margins.

CUBE has trouble seeing a path to greater profitability in the near-term and feel shares, after this big run, are no longer as enticing and the risk-reward isn't as attractive. We do believe the company deserves a premium valuation for being the leader in its space with solid recurring revenue but ultimately believe the market is pricing a lot of that in already. We view AAXN as a neutral/hold.

DISCLAIMER

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