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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the AeroVironment Fiscal Year 2022 Second Quarter Conference Call. (Operator Instructions)

I would now like to hand the conference over to Jonah Teeter-Balin. Thank you. Please go ahead, sir.

Jonah Teeter-Balin - *AeroVironment, Inc. - Senior Director of Corporate Development & IR*

Thank you, and good afternoon, ladies and gentlemen. Welcome to AeroVironment's fiscal year 2022 second quarter earnings call. This is Jonah Teeter-Balin, Senior Director of Corporate Development and Investor Relations for AeroVironment.

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 other filings 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 on 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, December 7, 2021. 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. - Chairman of the Board, President & CEO*

Thank you, Jonah. Welcome to our fiscal year 2022 second quarter earnings conference call. I will start by summarizing our second quarter performance and discuss recent achievements. Next, Kevin will provide a more detailed summary of our financial performance for the quarter. And then I will follow up with a discussion of our goals for fiscal year 2022 before Kevin, Jonah and I take your questions.

Let me emphasize 3 key messages, which are included on Slide #3 of our earnings presentation. First, we delivered solid financial results in our second quarter and first half of fiscal year 2022 in line with our expectations. Second, we are experiencing stronger macro headwinds this quarter. These headwinds include supply chain constraints due to the global COVID-19 pandemic, delayed awards of several customer contracts due to an uptick in pandemic-related travel restrictions and lack of approval of National Defense Authorization Act for government fiscal year 2022, resulting in continuing resolutions and a tight labor market. All of the above factors are impacting our outlook for the second half of fiscal year 2022.

And third, with a solid backlog and enduring long-term demand for our portfolio of solutions, we remain confident in our vision for the company and ability to create long-term shareholder value.

Before going through these themes more in depth, let me summarize our financial results for the second quarter. We delivered revenue of $122 million compared to $92.7 million last year, a 32% increase year-over-year. The revenue growth was primarily due to increased sales, particularly in our Medium Unmanned Aircraft Systems segment. These, along with other organic and acquisition increases, offset the negative impact from lower small unmanned aircraft systems product line shipments.

We achieved solid backlog of $252 million driven by new wins across multiple business segments and in part by recent strategic acquisitions that are already yielding strong results.

Gross profit for the second quarter was $42.5 million, an increase of 4% year-over-year. Gross margin percentage fell to 35% from 44%, reflecting product mix and supply chain effects.

We reported net income of $2.5 million or $0.10 per diluted share as compared to $2.1 million or $0.09 per diluted share for the second quarter of fiscal year 2021. While we're pleased with our results this quarter and still expect year-over-year growth across our business, we're adjusting our guidance for the full fiscal year 2022 to account for the headwinds we expect in the second half of the fiscal year.

On last quarter's call, I touched on 3 global issues that could impact our business: the U.S. withdrawal from Afghanistan; the COVID-19 pandemic; and the global supply chain disruptions. Today, I would like to provide an update on the latter 2 as well as additional headwinds affecting our business and the broader industry and economy. These additional headwinds include contract awards due to the global pandemic and current continuing resolution environment and labor shortages.

As we mentioned last quarter, current supply chain constraints are impacting our business. There are 2 aspects of this. First and foremost is our ability to manufacture and deliver products to customers in a timely manner. Supply chain bottlenecks have hindered our ability to do this, even as our dedicated teams have focused on mitigating the situation to the best of their abilities in the last 12 months by working with new and existing suppliers to find component parts.

The other aspect of this predicament is increased cost, reflecting higher material costs, shipping expenses, warehousing costs, inventory costs and overall working capital management as we continue to build inventory to meet current and future demand for our innovative solutions.

With regards to COVID-19 pandemic, increased concerns over the Delta and Omicron variants of the virus have resulted in further domestic and international travel restrictions. This, along with other pandemic-related delays, negatively impacts our ability to secure new contract wins in a timely manner, both domestically and internationally, even though our backlog remains robust.

Additionally, due to the current U.S. DoD's continuing resolution budget environment in Washington, certain awards have also been negatively impacted. We expect this uncertainty to persist throughout the rest of this fiscal year. We have worked diligently to meet the administration's mandate to have all employees vaccinated by January 4, 2022. However, this has led to increased challenges in hiring within an already tight labor market. The staffing challenge, to an extent, is hindering our ability to hire adequate qualified engineering professionals across our growing business.

It is important to emphasize that our commitment to AeroVironment and delivering value for our shareholders and other stakeholders remain stronger than ever. So these challenges in aggregate, namely global supply chain constraints, ongoing pandemic-related constraints, U.S. DoD's continuing resolution and tight labor markets, have led to a slower contract award environment in general and is hindering our ability to achieve the expected full-year results we initially intended.

Due to these headwinds, we find it appropriate to adjust our guidance for fiscal year 2022 as follows. Full-year revenue is now expected to be between 440 and $460 million. Net loss from continuing operations is forecasted to be between 12 and $8 million. Adjusted EBITDA is anticipated to be between 59 and $65 million. Our diluted loss per share will be between $0.47 and $0.33, and non-GAAP diluted EPS is forecasted to be between $1.23 and $1.37.

While these results differ from our initial expectations, rest assured, our team is dedicated to mitigating the issues. Some of these issues may be transitory in nature. However, supply chain constraints and tight labor markets in particular do not appear to be short term and we've already begun working to mitigate their impact this fiscal year. We're optimistic that such issues will also eventually work themselves out, but we currently lack visibility in terms of when that may occur.

Before turning the call over to Kevin, I'd like to provide some updates on current developments within our individual product lines. I will start with our Small Unmanned Aircraft Systems, our largest product line, where we were pleased to see growth opportunities ahead. We continue to see strong demand for our Puma AE and Raven systems, both domestically and abroad, and recently showcased a sensor-to-shooter demonstration, including Crysalis integration. This took place in September as part of NATO's robotic experimentation and prototyping augmented by Maritime Unmanned Systems 2021 event, Europe's largest maritime unmanned systems experimentation exercise hosted at the Portuguese Navy Center in Troia, Portugal.

This successful maritime demonstration of our Puma 3 AE Small UAS and Switchblade 300 tactical missile system was part of a U.S. and NATO interoperability to interchangeability initiative. It showed that our sensor-to-shooter solution dramatically elevates operator situational awareness and reduces the chances of mis-targeting, which we believe should help with broader adoption of these intelligent systems for naval applications worldwide.

In September, we announced that the U.S. Army exercised its third and final option under the Flight Control Systems or FCS domain of a multi-year Small UAS contract. The value of this option was approximately $11.7 million, including flight control system kits, ground control stations and various spare parts for the Army's existing fleet of AeroVironment systems. Delivery of this contract award is scheduled to be completed by September of next year.

Next, within our Tactical Missile Systems segment, we continue to see growing demand for our products and believe there is a great opportunity to replace traditional munitions on ground, air and sea vehicles. In the quarter, we successfully demonstrated the integration of our Switchblade 300 loitering missiles and JUMP 20 medium UAS for increased mission autonomy and efficacy.

This air launched effects proof-of-concept demonstration took place in August, launching an inert Switchblade 300 from the JUMP 20 and successfully recovering both air vehicles. This end-to-end integrated solution provides customers with greater time on station than if they were to deploy a Switchblade on its own, resulting in the ability to conduct more real-time surveillance, increasing the probability of identifying correct targets and minimizing collateral damage.

We continue to make progress on our Switchblade 600. We are actively manufacturing low rate initial production quantities for operational fielding of the ground version, while developing the maritime variant under our existing customer-funded R&D contract through its integration into naval vessels for the U.S. Special Operations Command.

I will now move onto our Medium Unmanned Aircraft Systems segment, which has been quite active this year. Following our recent success with SATCOM, we submitted a JUMP 20 proposal for the U.S. Army's Future Tactical UAS or FTUAS Increment 1 and will soon submit a proposal for Increment 2 opportunities.

In aggregate, the U.S. Army's FTUAS program is expected to be worth over $1 billion in potential opportunity over a 10-year period. As a reminder, the U.S. Army's proposed fiscal year 2022 budget calls for over $140 million of funding for progressing this potential program. We're very focused in competing for this large growth opportunity and expect to be awarded a contract for the Increment 1 opportunity soon.

We're also engaged with international customers to bid on additional future potential opportunities and ensure strong growth in the years to come. It has been an exciting few months for our Unmanned Ground Vehicles product line, which was created through our acquisition of Germany's Telerob. Telerob recently received a multi-million dollar firm fixed price order from the Latvian Ministry of Defense for telemax EVO HYBRID and tEODor EVO unmanned ground vehicles, along with engineering support.

We also delivered a telemax EVO HYBRID to the U.S. Pentagon Force Protection Agency earlier this summer. Designed to be operated by EOD and HAZMAT technicians, the Telerob UGV can safely and effectively dispose of explosive ordnance, hazardous material and chemical, biological, radiological and nuclear threats. We're pleased with the expanding interest shown in these products since our purchase of Telerob earlier this year, and believe in the significant value potential for our shareholders.

In our HAPS product line, we continue to move ahead in designing the next-generation aircraft under the terms of our 5-year master design and development agreement with SoftBank. As we said last year -- last quarter, we are progressing with Phase 2 of our partnership during which we will build a third aircraft to perform further flight testing, demonstrate longer duration flights and progress through FAA certification. At the same time, we continue to assess various U.S. DoD opportunities that can leverage Sunglider's unique capabilities. As a reminder, our Solar HAPS performance characteristics provide unique defense applications for both counterinsurgency and peer and near-peer conflicts.

And finally, our MacCready Works Advanced Solutions group continues to develop new applications in autonomy and artificial intelligence. We are engaged in many customer-funded R&D projects in the area of autonomous multi-domain robotic solutions and have seen new levels of interest since the success of Ingenuity, the Mars Helicopter, which our MacCready Works team help design for NASA. We are very proud of these accomplishments, which underscore our leadership in designing and delivering state-of-the-art solutions with high reliability and ruggedness for extreme environmental conditions.

With that, I would like to now turn the call over to Kevin McDonnell for a review of second quarter financials. Kevin?

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

Thank you, Wahid. Today, I will be reviewing the highlights of our second quarter performance during which I will occasionally refer to both our press release and earnings presentation available on our website.

Revenue for the second quarter of fiscal 2022 was $122 million, a 32% increase from the prior year's comparable period. Slide 5 of the earnings presentation provides a breakdown of revenue by segment for the quarter.

Small UAS led the way with $54.7 million of revenue, which was down slightly from last year's second quarter of $58.3 million. Our newly acquired Medium UAS segment had a strong second quarter with revenue of $26.5 million, a sequential improvement versus our first quarter of fiscal 2022.

Our Tactical Missile Systems or TMS segment contributed $18.4 million of revenue during the second quarter. The TMS was impacted by supply chain issues in this -- in Q2 and we expect these issues to continue at least for the remainder of the fiscal year. Revenue from the other segment, which includes HAPS, increased year-over-year to $22.4 million versus $15.4 million in fiscal 2021 second quarter. The increase is a result of revenue from the acquired Progeny ISG and UGV businesses.

Year-to-date, we saw a decline in organic revenue of 12%. As Wahid discussed in his remarks, we continue to face headwinds on many fronts and expect organic revenue growth to be limited or decline in FY 2022.

Turning to gross margins. Slide 5 of the earnings presentation shows the mix of product and service revenue. We saw some improvement in mix to 58% product, up from 53% product in Q1. For the full year, we are tracking towards a 55% product mix, down from our original expectation of 60% product. Our reduced revenue outlook has a disproportionate negative impact on product revenues.

Slide 6 of the earnings presentation shows the trend of adjusted product and service gross margins and Slide 12 reconciles the GAAP gross margins to adjusted gross margins, which exclude intangible amortization expense and other noncash purchase accounting items. I will speak to our adjusted gross margins.

Overall adjusted gross margins for the quarter were 39%, up from 32% in the first quarter of FY '22. This positive trend was a result of improved product service mix and improved product and service margins. Adjusted product margins in the quarter were 48% versus 42% in the first quarter. However, for the remainder of the year, we expect to see product gross margins in the mid- to low-40s. In terms of adjusted service gross margins, we also saw sequential improvement to 27% in the second quarter versus 22% in the first quarter of the year. We expect the Q2 service margins to be indicative of what we will see for the remainder of the year.

Now turning to operating expenses. SG&A expense for the second quarter was $24.8 million and includes intangible amortization and acquisition-related expenses of $5.6 million compared to $0.5 million last year. When you exclude the intangible amortization and acquisition-related expenses, SG&A expense as a percentage of revenue in the second quarter of fiscal 2022 was 16%. We expect SG&A, excluding intangible amortization and acquisition-related expenses, as a percentage of revenue for the year to be in line with the first half actual of 17%.

R&D expense for the second quarter was 12% of revenue and 13% year-to-date. We expect R&D as a percentage of revenue to be in line with our guidance of 11% to 12% for the full year. We also had a significant non-operating item in the quarter. We accrued an additional $10 million of legal settlement expense related to the claims by the buyers of our former EES business as part of a settlement agreement. This was recorded as part of the other expense in the quarter.

Looking at the bottom line. Our GAAP net income for the second quarter of fiscal 2022 was $2.5 million or $0.10 per diluted share compared to net income of $2.1 million or $0.09 per diluted share for the second quarter of fiscal 2021. The year-over-year increases in net income was primarily due to a $12 million increase in tax benefits and a $10.7 million favorability in equity investment income as the second quarter of fiscal 2021 includes a loss related to the HAPS Loon write down. This was largely offset by a $10 million -- $10.6 million decrease in operating income, primarily driven by an increase in intangible amortization related to the acquisitions and a $10.1 million increase in other expenses for the recording of a legal settlement discussed previously. The large tax benefit in the second quarter of fiscal 2022 is driven by a combination of our year-to-date and projected full-year pre-tax losses.

In terms of adjusted EPS, Slide 10 of our earnings presentation shows a reconciliation of GAAP and adjusted or non-GAAP diluted EPS. The company posted adjusted earnings per share -- per diluted share of $0.78 for the second quarter of fiscal 2022 versus earnings of $0.48 per diluted share for the second quarter of fiscal 2021. Year-over-year improvement in adjusted earnings is a result of increased adjusted gross margins offset by higher operating expense and positively impacted by the tax benefit in the quarter.

Turning to the balance sheet. Total cash and investments at the end of the second quarter was $124.2 million, which is slightly up from the first quarter of this fiscal year. We continue to have a strong balance sheet with over $120 million of cash investments and $100 million working capital facility.

Now, I'd like to highlight some of our backlog metrics. Slide 7 of the earnings presentation provides a summary of our current fiscal 2022 visibility. As of today, total visibility towards the midpoint of our $440 million to $460 million revised revenue guidance range is 90%. Our funded backlog at the end of the second quarter of fiscal 2022 was $252 million.

Now, I'd like to turn things back to Wahid.

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Thanks, Kevin. As you can see, we continue to make progress in advancing our market-leading positions while achieving critical milestones. Before turning the call over for questions, let me sum up the quarter with 3 key messages.

First, we delivered a solid quarter and first half in line with our expectations. Second, we're experiencing with -- experiencing macro headwinds in the second half of fiscal year 2022 and to account for these challenges we have adjusted our fiscal year guidance. And third, with a solid backlog and 90% visibility to the midpoint of our guidance range, we remain focused on delivering another year of top-line growth across our business portfolio while delivering long-term shareholder value.

We continue to expand the company's base of business, strengthening our leading position across the unmanned robotic systems landscape. Our team remains committed to managing the near-term macro challenges while achieving the long-term vision of our company and creating shareholder value.

Looking ahead, we continue to execute our strategy of broadening our capabilities, integrating multi-domain robotic systems, artificial intelligence and an intuitive user interface to provide more effective solutions than ever before. We've enjoyed the opportunity to meet and speak with our investors over the past quarter, and thank you for your continued interest in AeroVironment. We wish you and your loved ones a great holiday season and happy New Year.

I want to say thank you to our customers, team members and shareholders for your support and for challenging us to deliver excellence. We continue to focus on delivering on our promise to help you proceed with certainty.

Kevin, Jonah and I will now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from Peter Arment of Baird.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Wahid, can you talk about the -- mainly whether you can parse out kind of the revenue change on the outlook, whether it's -- how much of it's kind of driven by the CR, how much is driven by maybe kind of supply chain or maybe just give us some additional color there?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Sure, Peter. So, overall, as I mentioned, we're experiencing those primarily 3 headwinds, the 3 categories. And I would say the supply chain and supply chain related constraints are a significant contributor to that headwind. So we've been able to address that for the last 12 to 18 months very effectively so far. However, what's happened is that the length and duration of this pandemic and the restrictions that has gone along with it, no one really expected it to go this long.

And so therefore, as a result, all of the preliminary and proactive measures that we have taken for the last 12 to 18 months essentially were exhausted where the supply chain as a whole, even suppliers and distributors and manufacturers were not able to help us anymore because we've proactively planned so much of it. And so we adjusted our plans accordingly. And then the other 2 issues will be related to order delays as some of that related to the pandemic and travel, some of it related to good supply chain and some of it related to obviously the CR as well.

And then, lastly, but also tight labor market, especially for highly, highly technically qualified engineering talent, which we have a strong desire and demand for because our business continues to grow, has been another contributor. We haven't really broken it down specifically to dollar amounts per, but those are the top 3 areas that contribute to overall headwinds for us, Peter.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And then just as a follow-up, if I could. Is this -- does it feel like it's more timing related when you think about kind of the order delays and that you would expect those to eventually come back to you? Or are you seeing any changes by your customers?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Sure. So as I said on my remarks, some of these things are very transitory. So they will most likely work their way out sooner rather than later. But there is -- for example, the travel delays, we believe, that it's going to start to get better and they had gotten better and now the Delta variant and the Omicron variant sort of threw a wrench on that. So those, I believe, that over the short term is eventually going to work its way out. But it is a very dynamic market. It is -- things are changing literally on a daily to the weekly basis in terms of the supply chain and the constraints that are out there. And so it's really difficult to predict that far ahead.

However, there are certain issues such as the global supply chain constrain itself in terms of high performance, cutting-edge graphic processors, image processors and semiconductor components that we use quite frequently and majority of our products are -- and the labor market seem to be sustained for a little longer than we expect or we foresee. So we'll keep you updated as we get updates, but it's a very dynamic situation that we're watching very carefully and we're mitigating issues as they come up on a daily basis.

Operator

(Operator Instructions) And our next question is from Ken Herbert of RBC.

Kenneth George Herbert - *RBC Capital Markets, Research Division - Analyst*

I wanted to just obviously follow-up on the guidance question. But from an EBITDA standpoint, you've lowered the full-year EBITDA significantly more than the full-year revenue outlook. Can you just talk about the puts and takes from an EBITDA standpoint? And are there any specific items impacting EBITDA or profitability disproportionately relative to the revenues?

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

Well, I mean, I think it's because -- let me start and Wahid can wrap up. Basically you're taking off some of the higher margin business when we took out that guidance. So that's one of the reasons why it has a disproportionate impact on EBITDA.

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

And we also have this adjustment throughout the second half of the year, Ken, where there are some fixed cost based on volume that address -- that affects that too. So having a lower volume in general would negatively -- more impacts the profitability profile for this fiscal year. And so those are the 2 main effects. That's one driven by mix, which Kevin said, primarily the products because we generally deliver a lot more products than services as a mix of our revenue. And so those products with the shortcomings that we have in terms of the headwinds and supply chain and all that gets affected, and that has a bigger impact on growth -- on margins and profitability than services in general.

Kenneth George Herbert - *RBC Capital Markets, Research Division - Analyst*

Okay. And, if I could, just a follow-up on that. On the revenue side, were any of the push outs due to specific competitive losses or contract sort of setbacks relative to expectations on specific programs, Wahid?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Not so far that we know of. In fact, our team is making very good progress in general in terms of the markets and opportunities that we're pursuing. We, in fact, in many areas look better than we did before. As I mentioned, we did the interoperability interchangeability demonstration with the NATO partners and Europe. This is a very, very big milestone because it shows how a sensor-to-shooter concept of operation can be implemented and we delivered that capability. We demonstrated it live with our Switchblade and our Puma AE 3s.

Additionally, on our MUAS, the JUMP 20, FTUAS program for the U.S. Army, we have already submitted our proposal. We like our chances. We believe that we are in a leading position, and that is a significant opportunity that we think we are positioned quite well on that as well. And similarly in our Tactical Missile Systems product line, we've made quite a decent progress in a lot of the areas of our business. We are continuing to make products and deliver on the existing Switchblade 300, although at a slower pace because of the supply chain constraints.

Switchblade 600 is progressing very, very effectively with the customer adoption and lower initial production, and we're developing a next variant of it. So, overall, our win rate in the market remains strong. It's just that these headwinds are pushing things that are right as it's affecting pretty much almost every company that I know off across the board and the entire macro level of the economy and the industry.

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

And the product, TMS has shown a lot of good reception in the marketplace out of the box.

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Absolutely.

Operator

And our next question is from Austin Moeller of Canaccord.

Austin Nathan Moeller - *Canaccord Genuity Corp., Research Division - Associate*

Wahid, I just have a quick question here on the supply chain. Some other contractors that I've spoken with in the past few weeks have sort of targeted and estimated resolution for a lot of the supply chain delays and disruptions for sort of mid calendar year '22, which is of course in your fiscal year '23. I know you didn't say anything specific around timing, but does that sound like a reasonable estimate to you?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

In general, as I said, based on what we could see in the market, the tight labor markets and supply chain constraints that are affecting both delivery of our systems and services as well as the ability to manufacture and make products and delay the orders, I think that those 2 are going to be a little more sustained. There is really this type -- the situation is so dynamic that on a weekly basis things do change quite significantly. And we've been -- from the beginning of this pandemic, we were very fortunate because our team proactively worked on a lot of these issues in advance. We diligently worked all these things proactively by buying parts in advance, by getting our suppliers even carry inventory for us in advance, and plan and build in advance.

And so most if not all of those what I call contingency plans were exhausted in terms of the duration of this pandemic and the duration of this global disruption. And so essentially what's happening now, there is lots of different factors that are impacting it. What we're doing though, we are absolutely doing everything to control things that we can. Things that is out of our controls, we really can't control, that's external, but there's a lot of things that we can control and we've impacted that. So, I would say, in some ways, the beginning of next -- the middle of next calendar year summer, sounds reasonable, but I don't have a very clear picture there to provide you that.

Austin Nathan Moeller - *Canaccord Genuity Corp., Research Division - Associate*

Okay. That's very helpful. And then just one follow-up. If we look in the current drafts of the NDAA and the Defense Appropriations bills, there is approximately $68 million in there consistently for the Army LMAMS' Switchblade program and then around $70 million for Future Tactical UAS. I assume you still have a high degree of confidence in that ending up in your fiscal year '23 just once the budget is actually passed and sent to the President's desk.

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Austin, the 2 figures that you mentioned are accurate. Yes, those are in the proposed NDAA and the government fiscal year '22 budget's request. We're in contact with those 2 customers, the U.S. Army for LMAMS and FTUAS, and we really like our position. I am not in a position to comment about the fiscal year '23 activities. We are really focused on executing this year, but we do believe that the long-term prospects for our businesses and our product lines remain intact.

We are -- we continue to be a leader in this space and the markets that we're in. Overall, the demand for our products and solutions and our innovative capabilities are certainly there and enduring. And we're working hard to make sure that we capture those. It's just these headwinds that we're faced with, multiple of them of course, due to the external factors that are going on that we're mitigating as we go.

Operator

And our next question is from Pete Skibitski of Alembic Global.

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

Can we delve into the revenue or the guidance -- revenue guidance reduction by product line a bit? I would imagine you're seeing the most pressure out of the total in Small UAS and TMS. Is that fair?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

So Pete, this is Wahid. Generally speaking, as you know, a significant portion of our revenue comes from product sales and product shipments. And many of the issues that I described in terms of the headwinds impact the ability for us to manufacture product and deliver product, and also to secure contracts related to that. So, in general, those 2 are affected -- the product business overall will be affected in a large extent.

Now at the same time, since our product business is more favorable in terms of profitability profile, that impacts the bottom line a little additionally. And in the -- in addition to that, there is also additional expenses in expediting fees and material costs and warehousing costs, et cetera. So, overall, the reductions are impacting all of our businesses, but products are getting impacted slightly higher.

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

Okay. Okay. I think in your release you guys mentioned slower decision-making in DC. I wasn't sure if that solely meant the budget. I want to ask you if you've had any trouble getting FMS approval -- export approvals for any of your product given so much is now shipped overseas both for Small UAS and TMS.

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

So Pete, that's a very good point. In general, the slowdown -- there's some multiple factors that are impacting that. Number one, the global pandemic still serves as the deterrence and -- for the ability of our customers and our teams to travel both domestically and internationally as we used to do before the pandemic. That's one. Number 2, besides the travel, the continuing resolution that is happening right now in the U.S. defense budgets and Washington and government continuing resolution does also have an impact in our ability to actually process these things and move them through the sales cycle as we expected.

So in terms of the FMS office, yes, the overall impact of international shipments also are affected not just by the ability for the government to allow us to ship those things via FMS but also in actually securing and processing the paperwork to secure those contracts and get the permission to get them through. Overall, it's just a very large overall impact that the whole industry faced that are multifaceted.

Operator

(Operator Instructions) And our next question is from Brian Ruttenbur of Imperial Capital.

Brian William Ruttenbur - *Imperial Capital, LLC, Research Division - Research Analyst*

A lot of my questions have been asked. But I did have a question on Solar HAPS. Can you give us an update on that? Where are we? Are we on track? Has anything gotten delayed because of the pandemic, pushed to the right? Can you give us a general update there?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Thanks, Brian. Of course. This is Wahid. So in terms of the -- our HAPS business, as I mentioned, we're making really, really steady progress in that program in general. As you know, the business plan for that is a 3-phase business plan. We have completed successfully the first phase of this, which was design, develop, demonstrate and deliver to airplanes. Now, it's Phase 2, which is to make the final version of the airplane and then get this through certification and testing and flight testing with FAA and other agencies.

We have begun that process. We have a very detailed project plan that we have been executing. We're at the initial phases of that. The program is on track in terms of overall deliverables to our customer, our partner SoftBank and HAPSMobile. However, the shortages of resources of tight labor markets, whether the engineers that we need to expand and also to prepare for the next flight season, which is going to be upon us coming to summer, those 2 have been impacted because of this, including some supply chain and lead times for material.

So nothing has gone sort of untouched or unscathed in this area. But overall, relative to our plans with our customer and our partner, we're on track in meeting those milestones because we had already adjusted those based on the pandemic. However, this labor markets and supply chain is throwing another challenge at us at this stage of the game.

Brian William Ruttenbur - *Imperial Capital, LLC, Research Division - Research Analyst*

Okay. So there is some delays, but nothing really new in the last quarter on HAPS. Is that the summary?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

That is correct.

Operator

And our next question is from Louie DiPalma of William Blair.

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

I just have one question. Of the $100 million in guidance reduction, are you able to quantify how much of that $100 million is still in your pipeline versus how much you'd be able to deem like has been like canceled outright by the customers?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

So Louie, the majority of that is still in our pipeline. I don't break them down specific line by line because the line items are very, very extensive and large and long. Overall, in general, vast, vast majority of those have shifted to the right, either because of one or the other or multiple headwinds that I described earlier, in general. There are some level of sustainment orders that what we call it a little bit perishable. So if you don't have the ability to provide products or secure those orders that they will be reduced or may not come back, you may not recover from that.

The dollar amount of that -- the extent of that is difficult to quantify specifically. However, we have a very large installed base and we believe that over time that's going to work itself --- its way out and we're also, as you know, developing new generation solution that helps us generate new demand. So I would say, in general, majority has shifted to the right one way or the other. Some could be considered perishable that may not be recovered, primarily because of just time this goes by related to some of the sustainment orders.

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

Great. And of that $100 million, was there any specific contract concentration such that like there might have been like a very large Raven order or a very large Switchblade 300 order that you anticipated? Or would you say that it was like evenly distributed and it wasn't abnormally large relative to your normal contracts?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Louie, well, it depends on the product line specific because in certain categories we have a lot of different variety of things that we offer. So Small UAS, it's across the board, Puma parts, Raven parts and various different components that goes into the designing the subsystems. On our Tactical Missile Systems, the product line primarily is Switchblade 300 and 600. Those are the 2 primary drivers of our revenue for Switchblade and Tactical Missile Systems.

I would say those are the primary ones, but there is not one single specific opportunity or product because we use these advanced processors and semiconductor components across our entire product line. So if there is a shortage of a specific chip or semiconductor component, it affects more than one product of ours in general. We've taken a number of actions to address that, like I said, by even swapping components and redesigning the boards. We've done -- gone to other sources. We have bought in advance. We are exhausting all the possibilities that is in our control. But there are certainly large macro level headwinds that we can't control and that's the reason for the adjustment that we made on our guidance.

Overall, though, I can tell you that our 90% visibility to the midpoint of our guidance and a very strong backlog, $252 million, gives us confidence that we're going to be able to execute this year, but the situation is very dynamic. Things change on a daily basis.

Operator

(Operator Instructions) And our next question is from Pete Skibitski of Alembic Global.

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

1 or 2 follow-ups. Guys, a lot of people were talking about the potential for a full-year continuing resolution for fiscal '22. So we just don't really get a budget. So in light of that, you're halfway through your fiscal year. Should we -- how are you guys thinking internally about fiscal '23 just directionally? Is it reasonable to keep it kind of flat year-over-year? Or I don't know, maybe even down considering the lack of visibility on the budget and in the supply chain was the right way to think about that?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

Yes. So Pete, obviously, I'm not an expert in predicting the government's continuing resolutions situation. I will not speculate on that. But what I can tell you is that, we believe that based on the current environment and based on the visibility in the backlog and the visibility we have within our customers and markets and opportunities and our operations that we're confident about our ability to execute and deliver our fifth consecutive year of growth this year. And we are a growth company.

The demands for our systems and solutions in a long run remain strong. We believe that our Tactical Missile Systems is disrupting a very multi-billion-dollar large market opportunity, which we're just at the beginning of that. And our MUAS JUMP 20 system sort of presents a very large short-term and long-term growth opportunity for our business and our company. So -- and then of course, long term, our Small UAS as well as our HAPS business we -- did sort of present large, large step function up growth opportunities for us.

We're a growth company. We believe we can grow and we believe our -- the demand for our solutions long term is going to stay strong. And we will provide you more updates on fiscal '23 when the time comes close to that on our fourth quarter.

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

Okay. And last one from me on FTUAS. I think you said Increment 1 award could be soon. Just correct me if I'm wrong. But for Increment 1, is that a competitive down select or all 3 of the competitors getting award for kind of further refinement?

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

So that's a great question, Pete. I'm glad you asked the question because I alluded to that in my remarks, which was, we have submitted our proposal to FTUAS Increment 1. Increment 1 is strategically very important because Increment 1 sets the stage for the future program of record acquisitions, plans and requirements.

The customer initially indicated to us that they will be -- they have not determined what are they going to award it to ones -- only sole source to one vendor or multiple vendors. We believe we are in a very strong position, we have submitted a proposal for that and we like our chances and our profile for success there.

However, there is still work to be remained. It is a very large opportunity, there's lots of competitors that's competing for that, and we remain committed to making sure that we win in that opportunity because we believe our solution is extremely compelling and extremely differentiating compared to all the other options on the table.

Now the reason why Increment 1 is important is because that sets the stage for the government and the U.S. Army to inform its future deployment and acquisition planning. And while the dollar is small for Increment 1, the strategic important is significant.

Operator

Thank you. And there are no further questions on queue. Do you have any closing remarks?

Jonah Teeter-Balin - *AeroVironment, Inc. - Senior Director of Corporate Development & IR*

No. Thank you. We're ready to wrap up the call.

Wahid Nawabi - *AeroVironment, Inc. - Chairman of the Board, President & CEO*

We are ready to wrap up the call operator. Thank you all for your interest in AeroVironment, and we look forward to just talking to you again in the near future. And happy holidays.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you again for participating, and we look forward to speaking with you again next quarter. You may now disconnect.
