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AeroVironment, Inc. (AVAV)

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CORPORATE PARTICIPANTS

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Great. Good morning, everyone, and thank you for attending today Goldman Sachs Industrials Conference. We're really excited to have AeroVironment with us today, both the CEO Wahid Nawabi; and the CFO Kevin McDonnell. So let's kick it off.

QUESTION AND ANSWER SECTION

Q

I want to spend the majority of the conversation talking about the longer term, but I would like to talk a little bit about some of the recent happenings with the DoD. And what I think would be a good idea to start is to talk a little bit about the government shutdown and the impacts that, that has had to the business, although short-term and maybe specifically on order flow.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Sure. Thank you. Great to be with you. Thanks for having us. Obviously, the shutdown is not good for anybody in the industry. We're in our quiet period because of the second quarter results, which is going to come out about a week or so. So I'm not going to comment on Q2 results specifically. And we have, by the way, our – the statement on the...

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

A

Safe Harbor.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

...Safe Harbor statement, sorry – disclaimer in our website. And please read that if you can on our website, it's here as well. Generally speaking, the – we said at the beginning of the quarter that we are in the right categories, and we, obviously it's not good for anybody, but we're going to be generally speaking, we should be, look, okay at that time. That's what we said last quarter. And so I can't make any comment on that specific because of the quiet period of the quarter.

Q

Totally understand.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

Yeah, fundamentally long-term should not matter. If you ask about long-term, there is lots of funding that's going in all categories. Tremendous amount of money, and I don't think that's going to matter.

Q

Is there a way to think through the percentage of revenue in any given period that is from orders in that period?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

Not a lot. Usually the orders – there are some – in the BlueHalo side when we bought the company because their services business – the services business, the engineering high-end services, even though engineering services when if a customer says that we can't actually authorize you to do the work, then you have to stop the work. And that's what could be – could affect short-term. In terms of products, we are high churn, but not that high churn in terms of one-month or two-months' worth of period. Usually it's about three to six month long.

Q

Okay. That's, that's helpful. Maybe to shift to Russia-Ukraine.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

Yeah.

Q

It seems like, there's some talks now about potentially there being a ceasefire and some sort of agreement. I know that you guys have done a great job diversifying your business away from some of the Ukraine spike that you had a few years ago. How should investors be thinking through what Ukraine will be this year? And then going into calendar year 2026 and beyond, what is the new baseline for that business?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

Yeah, so the Ukraine really positive effect for us was two plus years ago, it was two years ago that we got a bump in that. We always said that as soon as that starts, we're going to pivot and switch over, pivot to other areas and diversify. Last year, we said that it's going to be less than 10% of our revenue, and this year it'll be even less than that, less than 10%, probably less than 5%. So Ukraine fundamentally is almost a non-issue and relates to – relates to our financials this year. The main reason is because we've already pivoted, besides pivoting ourselves to the US DoD and our allies, have a tremendous amount of demand for the things that we make. So we're positioned really well for a lot of that demand that's going to come through the next two to three to five years.

Q

Okay.

Wahid Nawabi

Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah, and essentially, Ukraine has become a non-issue, insignificant number, non-material in our financials.

Q

Okay. Yeah, yeah. That makes a ton of sense. That's a great segue. There's been a lot of talk about the replenishment that demand that's required on the back of the Russia-Ukraine conflict and then also some of the heightened conflicts that are happening in the Middle East. Is there a way to think through what that demand looks like over the next 24 months? And maybe like, how long it will take for current production to refill, or like to replenish...

Wahid Nawabi

Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah.

Q

...that inventory?

Wahid Nawabi

Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah, so that demand is really fundamentally a massive, massive sort of wind in our sails, if you ask me. What's happened is two or three things. Number one, drones, loading munitions, one-way attack from group one, two or three has become a very standard part of the military's operations and needs. So whatever the militaries of the world – our military, and as well as our allies had, it's probably going to go up to 10x to 50x higher, not 20%, but 10x to 50x higher, number one.

Number two, vast, vast majority of the inventories of the US DoD, and our allies, European allies specifically is completely depleted because they've basically given a lot of that stuff to Ukraine and with – are utilized. So the third thing is that because of the funding process and the budgeting process being delayed so much, the money hasn't actually arrived to the accounts, but there is billions and billions of dollars that are actually put – focused, and programmed towards long-range programmatic acquisitions in our category.

So we expect that demand to be significant over the next three to five years, A. B, the second thing is that you've seen from this quarter and the last quarter, the amount of long-term sole sourced IDIQ contracts that we've won.

We've announced over $2 billion worth of contracts just in the last three-plus months. And these are all sole-sourced IDIQ contracts with a total contract value of that amount. But it – the funding for those has not come in yet because their money that Congress approved for reconciliation, for example hasn't received, arrived into the accounts of the customer to be able to actually then authorize us to do that. We have been building in advance of that this year and we're going to continue to do that.

So majority of that demand is going to come in the next six months to a year and a half, in terms of orders and funding. And then, we will continue to deliver over the next obviously every quarter, but for the next two to three to five years maybe. So I think that we're just at the beginning of this cycle of the military's first realizing, we need to equip ourselves with a lot more of these things, A. B, a significant amount of dollars is being shifted, tens of billions of dollars to this – these categories. And then stockpiles are depleted, and we're positioned really well. And the thing that really matters the most is whoever can produce now and whoever has ready products that are relevant and they work in the theaters and the kind of conflicts that we have, they're going to have the lead – the best advantage. And there's no one that I can think of that is positioned better than us. I mean, we check all those boxes really well as a company.

Kevin P. McDonnell

Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

A

I mean, it's just as much about a shift in warfare as a replenishment story, though. It's not like replenishment is going to happen and that's going to be the end of the cycle. We're in for a long haul here of decades, plus of building up the types of categories that we're in and UAS, or lethal weapons, or things like this, or counter-UAS. So we're just at the beginning of a cycle of a shift in warfare.

Q

Understood. Wahid, you just made a comment about, like the funding isn't into the customer's account yet. What's stopping that?

Wahid Nawabi

Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Are you talking about the reconciliation bill funding?

Q

Correct. Yes.

Wahid Nawabi

Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Okay. So the reconciliation bill that was passed, obviously the shutdown happened right after that. And we have experts within our company that has actually been part of that process on the customer side, the department, the various Office of Management, the Budget, et cetera, et cetera. We know the process, we know exactly how the money gets flowed, authorized, approved, appropriated, and then makes its way. So based on our real close contact with all those different touch points, we have not seen the money flow through yet. And so the effect of this shutdown on the government side was significant because a lot of the folks that are actually working on these things, administrative folks, literally were not working.

And so that is going to take not a long time, maybe another two to three months, but it's going to flow into those accounts quite soon. And we've been given a lot of indicators that you've got to get ready. And that's why they've actually put the contracts in place. A couple of billion dollars within one quarter and there's more coming down the pipeline. Now, those contracts are not a one-year contract. Those are two, three, four or five year contracts. As Kevin said, this is a seismic shift in the market as to how the categories that we play in is going to be part of a bigger force structure.

Q

Yeah, so talking about shifts in the market, I'm curious to get your thoughts on Hegseth's recent announcements about the transformation of the procurement process?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah.

Q

And whether it's a way to kind of push the primes along and kind of give them enough of a – like a demand signal so that they can lay down investment for future demand? Or if it's more of a signal to them of, hey, the commercial model that a lot of these defense tech players like your company are deploying is where you need to start shifting to? I'm curious just on your take of like what the goal is of that and whether it's better for you guys or for the defense primes, or how you see it?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah, we are absolutely jazzed about that because the recipe that Secretary Hegseth is talking about is the recipe that we actually have been following and implementing for the last two-plus decades. If you look at our financials for the last two decades, ever since we've been public, our investments in R&D has been high, our EBITDA margin is relatively higher than most of the industry players. Our growth rates have been higher. And primarily because our recipe has been to invest ahead of the requirements, in fact help the customer develop the requirements based on innovating and disrupting the market.

So that is fundamental to our strategy in DNA. Now, what you see is dozens and dozens of other companies that are trying to copy the same model. In fact, lots of them, but benefit from very high valuations because they believe that this is the future. And so in our view we welcome that. We've been playing that game, so to speak with that strategy for the last two decades, and we would love it, number one. Two, because our systems are readily producible today and we have systems that are relevant from the latest set of conflicts that are out there, Ukraine, Armenia, Azerbaijan, Afghanistan, et cetera, we stand to be the leading player to benefit from this because our system is the easy button to push. So, we look forward to that actually.

Q

Yeah, that makes a ton of sense. Let's talk about Golden Dome for a second, because it seems to me similar to some of the comments you were making on the funding. Is there, but not on the customer account, I think people are expecting that we are going to have like the investment community is going to have an understanding of what the architecture was going to look like by the end of November.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah.

Q

When – like, how should we be thinking through when we will know what it's going to look like? Whether it's completely new incremental funding with that $25 billion, or if it's like repackaging existing things under the Golden Dome umbrella? What are you guys hearing? And like, what should we be looking out for?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Sure. So let me make a couple of points on this topic because it's somewhat misunderstood and not well understood in the industry. The Golden Dome effort initiative is a very large effort. There's lots of pieces to it. We're not trying to solve the entire problem of the Golden Dome. We're focused on a very specific part of the Golden Dome, the inner layer of defense, what we call the Halo Dome. The Halo Dome is our currently available solution set that's off the shelf, commercially available, that's actually already deployed. It includes our RF, our detection systems. We have RF jamming systems like the Titan or counter-UAS for directed energy, the laser system that we have called LOCUST, our software suite of products such as AV_Halo, and AV_Halo COMMAND, et cetera.

So that is the layer that we're talking about. So the bigger piece or another piece of that is the space and above Group 5, hypersonic and above type of capabilities that we want to defend against. So we worked and we partnered with SNC to actually develop the solution set. And we, as late as yesterday I had meetings within the Pentagon related to this specific topic. So that's what the Golden Dome is about and that's what our solution, it's about to address a very specific, but very important part of the Golden Dome initiative, and strategy and objective.

Second thing is that the money part. The money – the way the department is thinking about funding today, they don't have very specific dollars as to where they want to buy? What they want to buy? And what they want to spend money on? And how much it's going to cost? So, they are getting budgets and funding for large categories from Congress that allows the department to then actually make decisions as to how to deploy that funding and capital into what areas. So, there's lots of flexibility within the DoD – DoW on how to move money around from accounts to accounts on different categories to be able to spend that.

And so the dollars, there's certainly going to be billions of dollars spent on Golden Dome, certainly. No question. Is it going to be $50 billion or $25 billion or a $100 billion? We don't know. And in fact, the department has very good ideas, but they still haven't defined specifics yet. Yeah, but we're very involved in that category. We believe we have a very good solution. The reception from our customers has been significantly positive, very positive, and we continue to actually work with them in architecting the solution set because it has to fit as a jigsaw puzzle as a whole, all layers across the whole domain, all domains and we look really good because our solution set actually is relevant, it's commercially available, it's already deployed. We're actively engaged in these things, including the southern border of United States and other sites and so we're just waiting for the department to work through its design and efforts to then basically fund it and go forward. And there's also a question of how fast the money comes from the accounts to hit the their accounts as well.

Q

Right.

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

A

And in addition, that we'll benefit other area of business like our BADGER business and our space comm business and things like that, where all these areas will see increased investment over time.

Q

Yeah, okay. I want to get to the products and the growth, but before we do that, I just want to get one last one in on the funding environment.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Sure.

Q

What do you think will happen with the budget next year? Is it going to be the base budget plus some sort of growth, or is it the base plus the reconciliation with some growth? Or is it that there's going to be a base budget and growth and another reconciliation bill?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

I really – I'm not an expert to be able to comment on that specifically. What I can say is that whether the budget is flat or higher, I don't personally have a very strong knowledge of that or opinion on that. But what I can tell you is that the category that we play in is expected to be funded very aggressively, very aggressively. I see, not like one, two single-digit percentage growth in our categories. I see significant, in some cases actually order of magnitude more money being reallocated from other areas. As Kevin said, there's a shift in warfare. The two to three areas of the US DoD, and all of our allies are really focused on to double down and emphasize a lot more. It's – this war of drones. The way we see it every day.

And so that fundamentally is what we are as a company unmanned systems. That's one area. Directed energy space, RF jamming, counter UAS, one-way attack, these are very, very focused areas that the department is going to invest billions and billions of dollars more than what they did before. I mean, one-way attack three years ago was a zero market, almost none. So all of a sudden it's turning into billions and most likely they become tens of billions of dollars worldwide in the next decade.

Q

Yeah.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

So whether the budget is flat or slightly higher, I don't have an opinion. But I do know that the areas of the war, and continued – continues to get significant funding.

Q

Yeah. And I think what I'm hearing from you two is that, one, you don't make the decision on the budget, right? But it doesn't really matter for...

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

It does not.

Q

...like the stuff that you are involved in and you're aligned to is going to grow regardless based on the demand signals, so.

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

A

Absolutely.

Q

I think that that's important.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah, and we're such a small percentage of the total overall budget.

Q

Right.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

As of a – $1 trillion budget, we're a very small percentage of that whole budget. And – but that budget is probably going to double, triple, quadruple, it already has. We're in it – another indicator to realize, if you look at our business today, we're involved in a dozen different billion dollar programs of records. And we've mentioned many of these in several quarters, right? And we have a very high win rate, and we're generally number one or number two contender for these programs. So if you add that up, it's several billions of dollars of opportunity over the next decade or two.

Q

What is the win rate?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Oh, generally speaking we are rarely, if we engage in a program, we lose a competition, it's high-80s, up to 90%.

Q

Well.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Generally, it's very high, and for us usually.

Q

And does that make you think strategic – like in a strategic way that maybe you should bid on more things? And it should be a lower win rate, or is that like you're 80% to 90% is like your sweet spot? You guys are comfortable there.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Well, it's, it's, it's really not based on because our win rates are high, let's go after more things. We do it because we're very disciplined and we're very focused and systematic on how we go after things. If we believe that we have the right solution and there's a market, and there's an opportunity, and we can have a differentiated, compelling solution that we can then defend long-term. And you could see that in our margins, you could see in our profitability, you could see in our growth line, we then go after it. And because we're very methodical and systematic, in my view, it itself lends to an outcome that has been very, very positive.

And so if you look at the programs that are out there today, we're the leading contender. And there's a couple of them that the government actually just announced. LRR is a great example, Long-Range Reconnaissance. Our P550 is purpose developed and designed for that particular program of record opportunity for the US Army. That's $1 billion opportunity, just with the US Army alone. And most likely internationally, that'll be a $2 billion product over the next decade. And so we're very focused on where we think things are going to go and how we should go after it, and make sure that we win.

Q

And when you're talking about that, those numbers, the $1 billion opportunity, the $2 billion opportunity, that's not annual, right? That's over...

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Over, over five years.

Q

...four, five years.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

That's right. The Army is actually published already. What is the force structure implementation of the – that solution set, the LRR. If you add up the number of systems that they want to deploy, it comes out to about $1 billion worth of acquisitions over the next, in the timeframe as of about three to five years. And so they would buy most likely as fast as they can as whoever can produce is the fastest. And we're the only two contenders left. And we were already down-selected.

And so in my view, that's a perfect example of the kind of programs you're going to see that we're going to be engaged in. LASSO is another one. That is a US Army program for the loading munition for our Switchblade, $400 million or $500 million that we actually announced at the last AUSA conference. So we've designed a product specifically for that mission and for that requirement.

Q

Makes a ton of sense. The biggest pushback that I get broadly on defense tech is that right now it's difficult to measure and model out what each of the different products can potentially grow to. And I guess my question for you is, we pick 2028 or 2030, whatever the right timeframe is. What are the maybe five biggest product lines, programs, growth vectors for the company? And how should investors think through modeling that out between now and then in the ramp up? And maybe Switchblade is probably good place to start, given...

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Sure.

Q

...you just mentioned it in the fact that you guys are building the new facility in Utah with the new production...

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

That's right.

Q

... facility.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

So, it's not that we don't want to help our investors and the market, and yourself and others to build the most accurate models possible. We would love to help as much as we can. First, and we will – I'm going to try to answer the question in more detail.

Q

Yeah.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

But first, let me describe the backdrop. Our strategy fundamentally is we're going after a very large categories that we can disrupt, and be the leader, and innovate, and have high growth and high value creation. We've got a dozen plus shots on goal, literally a dozen plus that we're actively pursuing. Each one of these opportunities is $1 billion, slightly less than $1 billion or a couple of plus billion dollars large.

Q

In terms of the total opportunity?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

The total opportunity over the next three to...

Q

Yeah, five years.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

The five years, call, right? Yeah, LRR being an example.

Q

Yeah.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

LRR is one of dozen such opportunities that we're involved in. And we have a leading position one, number one, number two, and most of these things. In some cases we're the only player like SCAR as Kevin mentioned we've already selected. So which one is going to happen, when is incredibly difficult to predict, to predict in terms of timing. That's the fundamental reason why we don't provide that level of granularity because it is really difficult to be able to time that from the customer's behavior and process.

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc. A

And Golden Dome is a perfect example.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc. A

Golden Dome. Exactly. LRR

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc. A

When things get...

[indiscernible] (00:21:58)

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc. A

... et cetera. Yeah, now, having said that, these are – there are certain areas that I can very confidently think that over the next several years, there's going to be major contributors to growth. Okay. number one. Two, overall, our business has the ability to be double the size we are easily over the next three to five years, easily. Our own internal long-term planning process tells us over and over again that we are absolutely in this mode. And if you look at our track record, it actually also suggests that we are able to deliver on that CAGR that we've talked about, both on top line and bottom line.

So the best way to look at it is you can decide which one you think is going to happen, but I can give you a basket of things that's going to contribute to the growth. The categories are loading munition like Switchblade is going to be big. We already engaged in multiple programs and we've got 10 to 20 different international customers that are lined up. They're going to buy Switchblade. They already starting to buy Switchblade. We've been announcing those left and right.

The other categories, one-way attack, the products that we've announced in that area. The other area SCAR and BADGER, that's a program that we've won, it's $1.7 billion worth of funding that's going to be put into that to modernize the entire US space satellites, geosynchronous satellites with our system [ph] space the race (00:23:14). Counter-UAS, RF jammers such as Titan is going to be a very key contributor to our growth. The LOCUST directed energy system long-term should be a significant contributor to growth. We have the world's best solution of that category, and almost every single one of these actually.

And then another one would be the laser communications. We just announced a program that was very significant [ph] almost $0.5 billion plus (00:23:39). And we were selected as the company that is going to essentially provide that capability to the US. Okay, and so these are fundamental categories that I believe – oh the other two I want to mention is our small UAS, which includes JUMP 20, JUMP 20-X and P550. Absolutely is going to be also another contributor.

So if you look at our portfolio, pretty much almost every product line in our portfolio is going to be growing. The only one that I think is not going to have above average growth is most likely the cyber, cybersecurity that is really people oriented. That's very exclusive capability that we have. That is not going to have hyper-growth right away. And – but the rest of them are all going to contribute very handsomely to the overall growth of the company. And we believe that we're going to continue to deliver on that growth. You want to add anything else?

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

A

I mean, we're looking at 15% to 20% growth over this time. And as Wahid said, I think doubling the next three to five years is, is very realistic for us. And all those categories he mentioned, all that have potential being close to $1 billion in themselves. So that's not even perfection to double in that amount of time.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah. And even the question that we struggle with ourselves is should we invest more and accelerate investment even more to have even higher growth than that? The likelihood of us having higher growth than what we're even expecting is way higher than the opposite. So because we're sitting in such a great position in the market. I mean, in my career at AV, it's never been this great in terms of...

Q

Problem to have.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

It is a perfect storm, how things are lining up and how we're positioned to benefit from that trend.

Q

Does that mean that you guys would consider increasing the level of IRAD as a percentage of sales. or are you guys comfortable with the level that you're at?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Today – for this year, we're comfortable where we're at. Absolutely, there is demand for a lot more, a lot more. And we have always said – Kevin and I, in every single call that that's a lever that we believe, it's a very strong indicator for the long-term higher growth. And so we've been high in general, relative to the industry. But I think this year we're okay. And over time, I believe there's opportunities for us to even go higher if we needed to and also go lower if we needed to. So we're going to just play year-by-year and see how the customer and the market reacts, and we're going to play accordingly.

Q

Perfect segue there to the margin discussion. I think there's just a lot of debate broadly with defense tech that there's a narrative that because – there's more IRAD spend, there's more commercial pricing, and therefore the margins can be higher. So I guess my first question is, when you're thinking through that decision tree of should we increase our level of IRAD is the expectation that you will be able to get higher margins on the back of that?

And then number two is when you guys get through this growth spurt that you have here, given that a lot of the business today I think is already commercial, where do you think you can get margins too? And I'm not trying to give you – not looking for an exact number. But like a framework, are we talking about, $20 million or $25 million – $20 million to $25 million, $25 million to $30 million...

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

A

Yeah.

Q

...on EBITDA margins would just be helpful.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Yeah. So look, we think that our R&D investment is going to continue to be high because we see so much growth and that's fundamental part of our recipe and our strategy in our business model. Where we're going to get scale is by having larger scale of operations and production. Supplier input costs, variable costs, and fixed cost are going to probably be lower. SG&A as a percentage of revenue could be lower. So we would get synergies in those areas.

Lastly, I do believe that because of our recipe over the years, you could see our margins. We've been very successful at not only maintaining, but actually increasing in some cases, our gross margin percentages overall, and our EBITDA margin really we were high relative to the market were much, much higher...

Q

Yeah, the highest in the industry.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Could we go higher? Yes. But the challenge for us, not challenge, the real question is how much do we invest in the long-term growth because we want to capitalize on this 5 to 10 year trend very aggressively and very strongly. And so that tells us that we need to keep the R&D investments high enough until we think that we need to lower so we can increase the margin. So overall, I think that the margins could be high teens. Could it be above 20%? Sure, it could be. But we are trying to balance between short-term and long-term, primarily in the R&D space. I'm not sure if you had any...

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

A

I would totally agree. I would say to remember that things like LOCUST, BADGER are going more to product and more commercial pricing over time. And so with that you might see higher gross margins, but a little bit higher R&D percentages. But we're definitely committed to at least where we're at, if not a little higher as those gross margins expand a little bit. But hopefully at the same time increasing the adjusted EBITDA percentage.

Q

And it seems like the international demand is really strong. Is it right to think that the margins on the international business are higher than domestic, broadly speaking?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

Absolutely. It's always has been, and it should continue to be so because the US DoD is our biggest customer. We negotiate a lot of contracts with them first. They're the first adopter of these systems. When we sell internationally, both FMS and DCS, which we actually sell on both categories, and we're very successful doing that. Probably one of the most successful companies that has been doing that for decade plus. The margins are higher. DCS sales internationally is by far the highest margin. Yeah, and those margins will continue to be very positive. And that should contribute to the overall mix and help the margins be strong as well.

Q

Okay. And then sticking on the margin conversation and maybe just a little bit more towards pricing.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

Yeah.

Q

I know that we've spoken about this before, but there's a narrative that now that there is more competition in the drone space and maybe I think it's specifically on Switchblade that could negatively impact the pricing over time, and there would be margin degradation. I'm curious of how you guys think through that narrative and why you think that's not true. It seems to me like, the capability set is just completely different, but I'll give you the opportunity to...

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.
A

Sure. So, I've been with the firm for 15 years or so, a little maybe more. I've heard that argument from the day that I joined the firm, which is, by the way, it's a valid argument, right? A, it's a legitimate argument. But we have demonstrated over and over, and over and over again that we can maintain our margins, number one. And then the second question is also there's this thesis that these new players are coming in and they're going to offer lower cost solution and they're going to beat us.

We do not lose on price. We are the price leader in the market. We are the largest producer in this categories as well. And so time and time again, we actually win against players that claim to be lower price. In fact, I can give you examples after example, after example of companies who've tried to compete with us, they're no longer in existence because they went out of business, not being able to actually compete against us. I was talking about one of them last night, [indiscernible] (00:30:40) Florida. I won't mention them. But for a decade plus they tried to copy the Puma, and the performance of that product is nowhere near. They eventually went out of business, okay?

It's just several – we've seen, I've seen a half a dozen to a dozen international players. And every country that we compete, whether it's Puma, or P550, or Switchblade, there's at least one or two or three other international players that claim that they have a similar solution with much lower price. Show up in the competition, we prevail, we win. And so we are the lowest cost producer. We have been able to successfully maintain our margins. And the last point I want to make is that we have an incredibly strong competitive differentiators and compelling value proposition. For competitors to come in and see us in these are is not easy.

When you have an army that uses several of your products and we have software stock, avionics, a vertically integrated IP and technology stack, it becomes very, very differentiated, hard to actually unseat and replace. That is something that we work on very, very strongly and systematically all the time. That's why we invest in R&D. That's why we invest in our family of portfolio of solutions. That's why we have common controllers for our product lines and our competitors. So, I believe that we're in a very good position when it comes to that particular issue.

Q

And is there a risk there's been a lot of headlines about there being a trade deal essentially where we're going to be buying, the US and allies will buy drones from Ukraine, given that they have capacity of something like $1 million – I forget the, the number, but it's very high.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Over a $1 million.

Q

Do you guys see a risk to that or is it more that – that's more of there's like bargaining chips and political negotiations that are going on with that? And it kind of doesn't really matter for your space?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

It's definitely the latter, number one. Number one, a lot of it is positioning, posturing and part of it is also on the Ukraine side, they want to sell the stuff, and they all want to get aid from us and other things. I don't want to see, US wants to do that too. Secondly, the most important point, if you add up all those things, most of it is talking about these first person view, FPV drones. That's less than like 5% of the budget. That is not where the value is. That's not where the market is. It is a very marginally small portion of the whole thing. In fact, an RFI came out, I think this morning by the US DoD, that they're going to buy maybe a total of $1 billion of that over the next two to three years.

But if you do the math, it's like, it's insignificant compared to the large. And being able to actually have a business model to successfully make money in that category is not easy either. The war in Ukraine is very unique and different than what the kind of conflict that we're going to fight. They're making drones and they're using it next week. You can't do that in US DoD. It has to be systems that's going to sit on the shelf in stockpiles for months, if not years.

There is a whole different set of requirements that goes into that. We're not into this close combat fight, which is you're shooting within a mile of each other. We had a conflict with China and in the Pacific or somewhere, you're talking vast, large distances. They have to be marinized. They have to work in a lot more complexity than those. Now, I'm not de-emphasizing that would not be part of the solution set, it will be part of a solution set. But it's a much, much smaller portion of it and we've intentionally decided not to play in that market, because we believe the much better value is all the other things that we play in, which were leader in.

Q

Incredibly helpful. And we have about 40 seconds. So I'll ask you my last one. Maybe just like an update BlueHalo. It seems like there's been a ton of positives out of it, especially given all the application for Golden Dome and now that you guys are about six months into being a part of the larger company, can you just give us an update of how it's going, is there anything that's been much better than expected or worse than expected, that sort of thing?

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

A

Sure. Well, overall we're incredibly satisfied and very happy and pleased with the acquisition. It's been tremendously good. We're aggressively integrating the two companies and businesses and product lines. We're doing very aggressive deep integration. In terms of the synergies on the costs side, we committed or we predicted about $10 million a year for the next two years. We're ahead of that. All of our projections show that we're actually going to overachieve that. We are generally speaking, we're doing great. The categories that play in, you've seen some of the wins that we've announced. We've invested over $1 billion worth of contract wins over the last six months that we've been together, less than six months, just as a result of the fact that BlueHalo is part of AeroVironment and AV.

So I believe that we're doing great. Number one, it was a great move for us as a company and we're going to continue to give you guys an update on that and we look forward to it. Has there been challenges? Of course, there's – it's part of doing acquisitions and integration. But we've chosen to go very aggressively. The cultures are very similar. The businesses are complementary. We're even mixing not only leadership in organization but also product lines are being integrated together. And so we're very pleased with that overall and we're on track and sometimes ahead of schedule.

Unverified Participant

Yeah, it seems like it's been incredibly successful so far. So, thank you guys so much. We really appreciate your times. This was excellent.

Kevin P. McDonnell
Chief Financial Officer & Executive Vice President, AeroVironment, Inc.

Thank you.

Wahid Nawabi
Chairman, President & Chief Executive Officer, AeroVironment, Inc.

Thank you.