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# AeroVironment, Inc. (AVAV)

## Jefferies Global Industrials Conference

# CORPORATE PARTICIPANTS

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

**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

# OTHER PARTICIPANTS

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

# MANAGEMENT DISCUSSION SECTION

## Sheila Kahyaoglu
*Analyst, Jefferies LLC*

Good afternoon, everyone. My name is Sheila Kahyaoglu with the Jefferies Aerospace Defense and Airlines Equity Research Team. Thanks so much for joining us for our AeroVironment fireside chat with Wahid Nawabi, who's Chairman and CEO and Sean Woodward, EVP and CFO. Thank you both for being here, especially in light of your stock being up 10% this morning on solid results. So always a much easier fireside chat when results are good.

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

[indiscernible] (00:18:09) every day.

## Sheila Kahyaoglu
*Analyst, Jefferies LLC*

There you go.

## Sean T. Woodward
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

Little cooler, little cooler.

# QUESTION AND ANSWER SECTION

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

There you go. So, upside from here only, great results on fiscal Q1 from a revenue and EBITDA perspective beating but maintaining your fiscal 2027 guidance. How do we think about the puts and takes in all that?

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

A

Thank you, Sheila. Thank you, Jefferies, for having us. Obviously, we had a fantastic quarter, not even a good quarter but a fantastic quarter. There's three main areas that we're focused on making sure that what we expected in terms of our plans that we deliver financially, which we did, and we met or exceeded pretty much almost all of our metrics financially. The second one was to make sure that we make strategic progress on the milestones that takes the company to the long-term plans that we unveiled in June, which has a pretty solid, aggressive, not aggressive, but realistic organic growth, both in terms of top and bottom lines. And then third was also that we're really scaling a whole bunch of different products and franchises to get it ready for significant growth over the next four, five years because we're at an inflection point and expanding capacity in several of our facilities. And I think we achieved those goals and surpassed some of those goals based on our own plans as well. So, overall, a great quarter. We're in a very, very good position.

I say this not lightly, but very seriously that decade-and-a-half time that Sean and I have been with the company, the prospects for growth and value creation has never been better. We've got lots and lots of momentum behind us. We're in the right categories. Regardless of what happens to the budgets within the US DOW or internationally, we're on the right categories with the right solutions. That's been battle tested, validated, and we've got the production capacity and we're scaling, and we can deliver now and they're very affordable. Those four or five ingredients just ideal scenario for growth and focus for the department and our allies.

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**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

That's great to hear. And one of the other things is your recent awards have increased your revenue visibility to 86% of the full year guidance. How do we think about what remains unbooked and execution dependent for the 2027 guide?

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**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Sure. Yeah. 86% quarter one visibility is a fantastic start to the year. Last year, looking at our visibility at the same time, we're at 82%. We ended the year pretty strong last year and the prior year at 80% visibility. So sitting at 86% gives us very strong confidence that we're going to be able to execute to our fiscal targets that we have. In terms of the remaining 14%, we have multiple different opportunities that we're tracking pretty much across our portfolio. There's multiple different opportunities coming through that we are tracking closely and obviously we'll announce and provide that information as additional awards come through.

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**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

Great. And the cadence still calls for about 45% of revenue and one third of EBITDA on the first half. Can you maybe unpack some of the Q2 EBITDA drivers, EBIT margin drivers and specific mix and volume impacts there?

**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Sure. Yeah, you're right. We continued with our 45-55 revenue split, first half-second half and one third-two thirds on the EBITDA. We see the second half of the year really being driven by higher sales volume, a little bit more favorable sales mix. Some of these key awards that we just announced, including the E-HEL Award and an International Directed Energy award. Those will ramp up from a revenue standpoint in the second half of the year, which has a little bit better margin profile than we've had in that segment too in the SCDE segment. So, we should see some improvements in the second half of the year driving the EBITDA, the two thirds in the second half of the year.

In terms of the second quarter, we're still maintaining a 45% revenue for the first half of the year and one third on the EBITDA, a little bit of a sales mix and some ramp up of new products coming to the market, which will have a little bit of pressure on our EBITDA and some increased investments that we continue to plan to make this fiscal year, we'll align to those targets.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

Can we maybe talk about – can we maybe discuss bridge investors from the backlog to the broader opportunity set? How do we think about what the opportunity set looks like remaining across Switchblade, FMS and [ph] tightening (00:22:23) capacity?

**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Sure. So, in terms of additional orders and backlog conversion?

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

Yeah.

**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

So, we have $1.5 billion of funded backlog. That's going to convert – 86% is going to convert this year. We're going to bring that into next year as well. Additional orders that we're tracking are going to convert to the second half of the year revenues. We've gotten some key awards on Titan. We announced a $80 million delivery order on a $500 million contract award for the domestic shield program. Those are going to convert to revenue this fiscal year. They're in our guidance. And E-HEL and the International LOCUST are also part of our guide this year, and we'll convert to revenue partially this year, and that's going to continue on for the foreseeable future the next few years.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

Great. And just on Switchblade, the Army IDIQ for $990 million while the international vehicle has not yet been utilized, how do we think about key milestones on the international vehicle and potential for any additional Army add-ons?

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**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Yeah. So, we just announced a delivery order, I think it is 12 for the army, $51 million that we got just in the last quarter or so. So that's continued demand that we're seeing on the $990 million contract. We still have some room remaining on that contract vehicle to support additional director requirements for the loitering munitions. And we have multiple different FMS cases as well as direct commercial sale cases for our Switchblade product in the pipeline, all tracking as scheduled and hopefully be awarded this year. And of course, we'll announce those as soon as we can. So multiple different FMS cases are working their way through the system.

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**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

Great. I guess just one more as I think about the demand and backlog outlook, book-to-bill was 1.5. How should we think about just the lumpiness going forward that's always been a watch area for investors and the sustainability of the demand? But I think maybe if you could talk about the demand metrics to cross-directed energy, counter-UAS and loitering munitions?

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**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Yeah. So, we had a great book-to-bill of 1.4 in quarter one, and our last 12 months are at 1.5, which is fantastic. It is lumpy. The business doesn't always have a steady order flows. There's certain quarters that are better than others. We're very happy with our first quarter at the 1.4 book-to-bill ratio. We love to continue with that, but we know the business there is some lumpiness in the cycles. There's been a lot of pent-up demand, a lot of dollars that were waiting to be allocated from the [ph] GFY 2026(00:24:45) budgets. We've been seeing that go through. We thought that was going to happen on the last call. We thought the summer was going to increase order activity, and we saw that play out as the orders were coming through, through our quarter one as well as into the second quarter that we've announced so far.

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**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

Can you maybe talk about LOCUST production and firm fixed price there? Maybe backing up, how do you think about LOCUST demand overall? And I know you discussed it in the June Analyst Day. And how do we think about the revenue contribution this year?

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**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Sure. So, LOCUST went from seven years ago beginning the development, handfuls of systems have been built over the seven years, demonstrated on ships, on land, on southern border in war zones. It's proven its capability. But it's been a very low-rate volume build so far. We are now investing in our New Mexico facility in Albuquerque, where we're putting $30 million to build out that production facility to scale the directed energy that's going to allow us to execute on the E-HEL program, that's going to allow us to execute on the international award that we received, as well as additional volume.

That E-HEL program is going to be over a multiple year window, roughly a four-year program. We expect demand both domestically as well as internationally to increase for the LOCUST product as the Army has put that seal of approval that they've awarded it to us. So, we're building up the capacity to support far greater than the current volume, up to roughly $0.5 billion a year type of volume for the LOCUST directed energy.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

And as you think about LOCUST, the $500 million of annual franchise opportunity, how do you think about the competitive landscape there and potential other service sales? Would it only be the Army? How you could think about that?

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

A

So, I mean, this particular win, coupled with the international win, I believe it's an inflection point for this business, for this product line. If you go back five-plus years ago when the Ukraine conflict started, loitering munitions in one way attack drones was nobody expected it to be or generally speaking in a public investor community and in militaries how big of a role it's going to have and the war. And that has changed the paradigm, and that's why it's close to $750 million business for us in the past four or five years from then. I believe that the LOCUST directed energy solution is in a similar inflection point with possibly a bigger market opportunity globally over the next 5 to 10 years.

The US military has been chasing and investing in directed energy systems for over 30-plus years, three-plus decades. And no one's been able to actually solve the problem reliably and effectively with a solution that's affordable, that's practical, that's resilient, that is also with a high level of reliability and availability. We've done that. Our system is in the fight, as Sean mentioned earlier, in different theaters of around the world, including the southern border. And the Army has been convinced now. And that's why they awarded us this $0.5 billion, the largest production contract for laser weapon systems in the history of the department.

And so, I believe that these two awards are going to start the knee and the curve where more and more services are going to look at procuring these things, protecting sites. We're very vulnerable and a lot of the ships that it's in the Central Command in the Middle East as well as in Asia Pacific. And then the economics of the current solution set doesn't work out. Every time, Iran, for example, fires a $150,000 Shahed, we use $1 million to $10 million missile to defeat one. We just don't have the battery, the depth of magazine or the economics to be able to sustain that kind of a conflict if it were to just go further with a larger adversary.

So, directed energy is really the Holy Grail when it comes to that type of a defensive mechanism. And this solution is developed for the US Army, the E-HEL program and X3 LOCUST to address Group 1, Group 2 and Group 3 drones effectively. And it's – as you said, it's mobile systems. It can go on ships, it could go on land, stationary, and it takes the cost equation to less than $10 a shot, from millions of dollars a shot to less than $10 a shot. And the second thing is, it gives you – as long as you have electricity, it gives you unlimited magazine, means you can keep shooting this as – so adversaries will lose that equation or that challenge if they were to compete with drones encountered and lethal drones with the LOCUST system. That's why I believe that the application for this is massive. And we're the first company that has done that. That's why we're scaling manufacturing.

Historically of any of our product franchises, when we get a very strong validated acceptance with the US Army or a US military, followed by especially an international award, the franchise adoption rate just takes off. It's happened to us half a dozen times in our history. Raven, Puma, P550 now, JUMP 20, Switchblade 300, Switchblade 600, this is something that we know how to do. We've done it several times in our history. So, I feel very confident that fast forward this scenario, a few years from now, it could be as big as a $0.5 billion to $1 billion plus business for AV. And it's also – we've designed the product to be a commercially viable product. So, we sell it as a firm fixed price commercial product. That's why we were able to actually successfully get a DCS sale, direct commercial sale with international ally. That also is the first time in the history of the Department of War in the United States where US has allowed a supplier like us, anybody, to sell and export a laser weapon system for military applications to a foreign country. It has never happened in the history of the department. So, I think these are significant milestones in the overall trend of aggressive adoption over the next several years.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

I have a few follow-up questions, if that's okay. Can you talk about LOCUST X3? What – so, as an Army platform, it sits on top of an armored vehicle. How could you expand it to potentially other services, and what differentiates that versus its competitors?

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

A

So, there's lots of differentiators in our solution versus everyone else's. There's lots of people that are chasing this. We really – a few things that's really important. Number one, we focused on the sweet spot of the market. A lot of players are going after much higher kilowatt power. That's like giving somebody bigger and more powerful bullets, but they don't know how to aim at the target. So, giving somebody more bullets or bigger bullets does not really solve the problem of somebody spraying the shots everywhere, if I were to use that analogy. The secret sauce to our system is that we are able to perfect the ability for a moving vehicle, such as a Humvee or a Stryker vehicle, armored vehicle, to be able to go in an uneven pavement at around 20 kilometers, 30 kilometers per hour, detect 365 degrees, 360 degrees around it, just real time, any type of drone from Group 1 to 3, and then aim at it and then basically zap it down within 3 to 5 seconds, and do that every few minutes as you reload and you recharge. That tracking, targeting and control hardware and software algorithm is something that we've been perfecting for a lot of lots of years.

Now, this base gives us the ability to expand the product line also at higher kilowatts and at lower kilowatts for a variety of other applications.

In addition to that, the way X3 is designed, not only can you detect while you're on the move, you can also hit and defeat drones while you're on the move. That makes it incredibly compelling and powerful, means you don't have to stop to do that action of actually hitting the drone.

And lastly, we have done many tests with our customers, including the US Navy, onboard aircraft carriers, ships, where they have given us – the latest one was we were given 17 real targets on a real mission with the US Navy on a ship, a George W. Bush, I believe, in Norfolk, where we they give us 17 different type of real targets. And our system hit 17 out of 17, 100% success rate. And so far, the success rate of this product in the field in terms of its availability also is very high. It's – there are very few systems in operation, and our customers just keep moving them around because it's in such high demand.

Last piece of data. Department of Homeland Security and Customs and Border Patrol has developed and deployed some of these systems in the southern border. They just published some stats on this that the success of LOCUST has been so phenomenal that the drug cartel drone traffic over the southern border has decreased by 70% plus, 70% plus. And it just shows the power of this type of a solution set and the technology that it has. And so, we're really focused on this. It's not the only one. We're very fortunate because we have a half a dozen of these growth opportunities in our portfolio. But I think LOCUST is going to be very unique because we've got a solution set that has a moat. It's very effective and our customers have already pushed, I believe, one, and we're scaling production and we can deliver them at scale today.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

And as you think about the international expansion, you mentioned that these franchise programs tend to come in waves and once you get one under the belt, more will go forward. How are you thinking about this international opportunity being tested in the timeline of potential other orders?

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

A

Yeah. So, I mean, historically, when we get adoption with the US military and the US government allows us to export and sell them to allies, the momentum picks up very quickly because, look, the world is not a safe place. Think of all the different theaters around the world, the Middle East, Straits of Hormuz, Eastern Europe, Mediterranean – Black Sea, Mediterranean Sea, Asia-Pacific, lots of these places, Gulf of America, Latin America, there's lots of places where systems like this could be dramatically effective and helpful to the needs of our customers. And so, once the government gives them the nod that this is validated, and I believe buttons pushed, I mean, we're in multiple active shooting wars around the world, and it's not a safe place, right? And you see drone attacks in places like the Middle East where Iran fires a thousand plus of these drones in a week. And basically, this just drives havoc into many countries' economies, let alone the global markets.

So, it's not a small little deal that we're talking about. This is something that is going to be very seriously, I believe, observed and most likely adoption is going to take off after that. It doesn't happen overnight because the acquisition process still takes time, it is a military sale, it does have to go through the governments, and we still have to ramp up production because the lead times on some of the materials are still very long. It's just a very new market, but we know how to do this. We've done it several times in our history, and we're executing on our plan.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

No, that's super helpful color. Maybe I'll ask two more on international and focus on your other products from here. You mentioned it's still a process to sell internationally. How does the export agency approvals help you, and how are you thinking about localized efforts as well?

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

A

Sure. So, another thing that's very unique about AV is that our success and track record of being able to sell and successfully export products from United States and our technologies internationally is phenomenal. We export to 55 different countries around the world and pretty much every continent except Antarctica. And so, we are very successful in knowing how to do that. We've been growing that before. And before the BlueHalo acquisition, international revenue represented at various times between 40% to 50% of the total company revenue.

I believe that the international markets adoption and revenue is going to grow even faster because there's tremendous need for our systems out there. We're actively engaged in several countries in those three markets. The key markets that we're focused on is Europe, Middle East and Asia Pacific. We have announced several joint ventures, subsidiaries, teaming agreements, partnerships in multiple countries. And I think that that's going to continue to grow.

In terms of local content versus not, some of these countries have such great needs and there's so much demand for our systems that it's going to require some local content. We have a very sound strategy around that. We know exactly how to do that without compromising our IP, without compromising our value proposition and the business model. And we know how to work with the US government and how to set these things up. We've done it many times in our past, and that's a strength of AV, in my view, in general.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

Okay. And that's super helpful. Can we talk about Titan as well, the $500 million IDIQ, just to touch upon that again and the initial $80 million order under domestic shield tied to Golden Dome? How do we think about that converting to revenues and further milestones?

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

A

Sure. So let me just touch on our overall strategy on counter-UAS. Counter-UAS, to us, is not just a product. Counter-UAS is a problem, and it's a category that is going to continue to grow over the next 5 years, 10 years. We never thought that you're going to have a one-solution, fits-all strategy for this market. Our strategy, which is unique compared to almost all of our competitors, is to have a layered defense solution set that addresses counter-UAS and multiple different types of capabilities. The first layer of that defense against UAS is RF jamming. We've got one of the world's best RF jamming systems in the world. Titan series is proven. It's worked in Ukraine. It's worked in the US. It's worked internationally. We're doubling revenue every year in the last couple of years alone, and it's going to continue to grow. And the example you just described, the order from the drone Shield program or the Shield and the Golden Dome initiative, is at roughly about $0.5 billion total contract award, sole sourced to AV, so we can actually build more of these and deliver them to the US military. We're going to deliver those things our portion of that $80 million, a significant portion of it this year. We're already actively ramping production. It's one of the product lines out of seven different ones that we're scaling production aggressively.

The second layer of our defense, just to go back to the counter-UAS, is the directed energy solution. So, if the RF jamming fails, which most likely in the future, as drones become more autonomous and independent of GPS and RF communication, then RF jamming doesn't work. So, then you have to go to the second layer of defense, which is directed energy. Directed energy is the technology that's going to become probably the lion's share of the use cases in the market for military applications. And you heard my story earlier as to what we're doing there and why we're the leader.

If those two layers fail, the last resort is to use a kinetic missile. In the entire arsenal of the US military's missiles, there is not a missile that is designed from the ground up that can address a group one, two, three drone cost effectively. Today, as I said, we use $1 million to $10 million missiles to shoot down $150,000 Shahed drone. That economically is not feasible. We have been awarded the contract. We competed with RTX on this called LRKI, Long-Range Kinetic Intercept (sic) [Interceptor] (00:41:11). It's a US Army program to develop a next generation counter-UAS missile, specifically at cost targets that changes that equation make it a parity economically feasible to do that. We're ramping up our Huntsville facility specifically to scale that site. The US Congress actually put more money and awarded us more funding to accelerate the production and transition to full rate production. And we're aggressively building those units, going through the safety confirmation and testing and maturity of that product to get it to a production level in the next 12 months to 18 months.

So, as you could see, our strategy is not a one solution fits all or solve part of the problem. We believe that the counter-UAS market is a multibillion-dollar global market. We've got the leading solutions in all three categories. And I think, over the next several years, we're going to continue to scale this and benefit from that growth as well.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

As always, super helpful to provide the macro perspective, and I think we all appreciate it, especially myself. So, on UAS, the revenues have been growing quite significantly. How do we think about the run rate going forward and sequential growth in that business?

**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Yeah. So, the first quarter, UAS revenue was up 71% year-over-year. So, we'd love to continue that trend going forward at that level of rate. We've had some key wins. We won in the first quarter a $117 million P550, our Group 2 solution for the long-range reconnaissance program of the US Army. That award is beginning its deliveries now and had it in Q1. It's going to continue in Q2, and it will be included in our full year numbers. Overall, UAS is continuing to grow. We're seeing tremendous adoption of our JUMP 20, our JUMP 20X, our Group 3 solutions in that space, both domestically and internationally. We've won multiple different programs internationally with our JUMP 20. We've recently got a military designation for it by the Italian government putting it into their inventory as a defined inventory item. And so, that's a really key milestone to win and prove the air worthiness and the overall capability of that platform.

So, our UAS platforms continued with Puma as well, and Puma has been around for a while, but we've enhanced it over the years, and we just announced a $30 million Germany award where the German military basically bought the full suite of our Puma capabilities, our Puma 80, our Puma long-range, our Puma VTOL, our autonomous kits they get added to it. They bought the highest capable Puma system out there, and we're going to be delivering that this year as well. So, UAS is doing very well. That's been part of our legacy for a while. And we're continuing to invest in it and expand the production capabilities and be able to deliver on all these key contract awards.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

Q

That's great to hear. And I guess putting all that together, how do you think about margins across the business going forward as you've laid out your margin plans back in June?

**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*

A

Yeah, so we did our Investor Day back early July and we laid out our fiscal year 2030 targets. That took us from a revenue standpoint of growing roughly 15% to 20% over the next four years, getting us to essentially doubling our company between $3.5 billion and $4 billion. We also put some financial targets around our EBITDA expectations. We're currently running – last year, it was at 14.5%. We're guiding 14.5% this year, and we expect that to grow to 18% and 20% by fiscal year 2030.

The way that we're going to get that growth and that improvement is by – obviously the volume is going to help, but also the mix. We're going to increase our product-related sales versus services. We're going to increase our firm fixed price-type contracts versus cost plus-type contracts, and we're going to increase our international sales that typically yield a little higher margin than domestic sales. All those things we rolled out in July, and a lot of those things are already happening through these recent announcements. The SCDE segment is where the LOCUST awards are being executed against. Those are going to help drive improvements in gross margins in the latter half for this year, as well as into the future as we transition more and more of the technologies that were acquired at BlueHalo into the production levels that we're expecting.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*
Q

Great. And maybe can we talk about despite those – the 400-basis-point margin increase in your target, you're – R&D has been a big part of AVAV double digits over the last decade. You're normalizing to more of a 7% to 9% range. How do we think about where you're spending the dollars?

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

Yeah. I'll take it. So, historically, before the acquisition of BlueHalo, the AV, old AV, I'll call it, R&D as a percentage of revenue was double digits between anywhere from 10% to even sometimes we went to 13%, 15%, the highest was actually 18% one year. I'm not indicating that for the future. I don't know. I just – don't have to panic about that. And BlueHalo had a slower rate. So, the combined rate, still the dollars is much bigger, but it's around between the 7% and 9%, as we discussed. We think that that's the normal range for us for the next several years, and it's going to fluctuate from year to year.

We have a very ferocious appetite for opportunities to invest in, but we're very judicious on how do we risk adjust these opportunities and rank them, rank and stack. And then we make decisions on the portfolio level as to where do we should we place our bets. Historically, AV has probably got one of the best track record of investing in a technology or an opportunity, and then over the next three years to five years, demonstrating how we can take that and build it into a franchise capability and product line and business line for us. So, if you look at the history of our company, it's literally made up of those layers of the cake. We've got several of those today. Majority of the investments are going in these specific areas. It's going into our bread and butter – no, no, multi-mission ISR drones, non-lethal drones, call it, precision strike systems such as Switchblade, Red Dragon, FE1, et cetera. Counter-UAS is getting a very heavy investments, primarily the LOCUST and the directed energy systems. And then we have a whole bunch of other smaller, earlier stage investments for, what we call them, breakthrough capabilities that essentially becomes a franchise later on. One of those that's actually you know about is Red Dragon. Red Dragon was not even known three-plus years ago. We developed it during the Ukraine conflict, and it's going to be a significant driver of revenue and profitability for the company this and next year.

And so, that's usually our strategy. That's we're going to end up doing. We're fortunate because the market for us to invest is actually pretty good. The returns on these things look really, really good, and you could argue that we should be higher in some cases. But we're trying to balance to two things, being judicious and methodical and very systematic in how we do this and to also we don't want to get too aggressive and also make sure that we have a profitable business and sustainable that way.

**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*
Q

That's super helpful color. I guess as we think about some of those margin drivers, services and international, have you quantified the mix change or percentage change that you look to?

**Sean T. Woodward**
*Chief Financial Officer & Executive Vice President, AeroVironment, Inc.*
A

Yeah. So, the overall mix is going to help drive that adjusted EBITDA from 14.5% up to the 18% to 20%. As Wahid mentioned, our historical international portion of our portfolio was a lot larger in a couple of years back. It has come to a smaller percentage as we've integrated a larger company with BlueHalo that was mostly domestic focused. So those percentages we're sitting in roughly 20-ish percent, right, international exposure. We expect that to grow to 30% to 35%, probably not getting back to 50%. We don't need it to get back to that level in order to hit those adjusted EBITDA targets. From a product and services, we're around 68% product, 32% services. We expect that to also improve, so a higher mix of product sales going into the mid-70s, which will help drive fixed price contracts which help drive margins as well. So, all those factors are in play. We're executing to that. These key awards that we're winning are all evidence that our strategy has pan out. Now, we're just going to see that our execution of the programs effectively, and ideally the margins will improve in the back half of the year and continue into 2028.

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**Sheila Kahyaoglu**
*Analyst, Jefferies LLC*

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Two more questions and we'll wrap up. BlueHalo, where are you on the acquisition integration today, and where do you look to be in the next six months to a year?

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

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When we did the acquisition, we had a very crisp and clear plan on a three-phase approach on how do we integrate the business, how do we execute our strategy on this, and how we go create value as the two businesses, one plus one equals way more than four or five. We're right now at a -, but I'd call it, 2.5, phase 2.5 roughly. Phase 1 was to basically get two organizations together, move the businesses and product lines in the right places, connect the plumbing and the wiring so we can function as a one AV company. Phase 2, which is the heaviest part of the lift, was to actually connect our systems, to be able to allow us to scale, scale both in terms of operations, the cost synergies, revenue synergies, customers, products, et cetera. We're about 60% to 70% or 50% between depending on which area you look at of that transition complete and successful.

Remember, this is a very large thing to take on, and we're going very deep in terms of integrating these businesses very aggressively, very aggressively. There's such thing as AV or BlueHalo anymore. We're one company. We're trying to go into one ERP system, one HR system, one salesforce CRM system, massive, massive amount of effort internally.

Third phase of the integration is actually streamlining our investments and products, and aligning our R&D and SG&A investments to make sure that we get one plus one equals 5 or 10. That takes a little longer because then you have to start – it has to be in a lot of the new development on new products, new technologies that allows us to spend a dollar and let five or six products benefit from that. That effort is already underway, too, but I would say it's maybe 20% to 30% done in terms of a just rough order of magnitude.

And so, last thing I would say is I'm very pleased with the progress we're making. Acquisitions, integrations of this size and nature is never easy. We have had lots of experience and track record here. And if you look at what we've been able to achieve, both – we've already achieved the cost synergies. We had a target for the first two years. We achieved that in the year, in the first year. We're ahead of our revenue synergy expectations and goals too. And the last 12 months alone, we've won four, five different $0.5 billion sole source programs and franchises, Titan, Freedom Eagle 1, Laser communication terminals, laser weapon systems like LOCUST. The list goes on. Helmsman is another program that we won. And so, we continue to win in our record so far of being able to create the type of synergy that we wanted them, the revenue side, I'd say it's quite, quite good. And so, we're very pleased with that, and there's a lot more to come. There's lot more to come. We're going to continue to work on this, and I think the combination of the two is strategically exactly what our customers want us to do and generate value for our shareholders.

## Sheila Kahyaoglu

*Analyst, Jefferies LLC*

Thank you both. I think that's a great note to end on.