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

OTHER PARTICIPANTS

Seth M. Seifman
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Seth M. Seifman

Analyst, JPMorgan Securities LLC

Here we go. Good afternoon, everyone. Welcome back to the Aerospace Defense Track at the JPMorgan Industrials Conference. I'm Seth Seifman, the aerospace and defense equity analyst here at JPMorgan. We are very grateful to have AeroVironment with us, AV. And we have both CEO, Wahid Nawabi; and we have CFO, Kevin McDonnell here with us.

Guys, thank you very much. We appreciate you being here. And there's a lot of stuff that's kind of very, very topical for us to talk about. So, thanks for coming.

QUESTION AND ANSWER SECTION

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Maybe we'll do – we'll just do some Q&A here and then I'll also open it up to the audience if anyone in the room has any questions. I guess we've got a lot to cover, but maybe starting off, it seemed recently that there was a little bit of slowness, maybe, in some of the funding that was coming out, particularly from the reconciliation bill. And I'm wondering now that the government's been back open for a few months, now that we're a little further into the calendar year, have you started to see more of those resources flowing? And when you think about what was in the reconciliation bill, where are the main the main opportunities for AV?

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

A

Yeah. So, thank you for having us, Seth. Yes, there were some delays primarily due to the government shutdown and the reconciliation bill and the CR that happened throughout the whole year. The budget just got approved a little while ago, not – a month ago or so. The dollars are still coming through from the approval process from the Congress to the OMB and from there it's going to flow into the specific accounts of the services: Army, Navy, Air Force.

We're starting to see some trickle of that. I think it's the beginning. In the next three to six months, I think we'll see a significant more uptick on the potential of orders coming in and contracts flowing down to us as well, A.

B, in terms of the is there a lot, or is there anything for AV in the reconciliation bill and in the budget? Absolutely. We're on the – some of the highest priority categories, we're on the strategic categories in terms of both demand and importance. Those are things such as drones, Group 1, 2 and 3, loitering munitions, one-way attack, RF detect and defeat jamming systems such as our Titan series, as well as is obviously requirements now because of the conflict that's going on in Iran, for Directed Energy LOCUST Systems that could be a very significant player in the long run.

I also mentioned that persistent, long-range – long-endurance ISR such as our Group 3 JUMP 20, JUMP 20-X, is ideal for those types of needs that are out there in the market.

So, there's half a dozen of our products that are in production today, we're making them in quite – probably the largest volume in the industry, and we have the capacity to produce and we have the ability to actually deliver at a military grade operationally relevant systems to the market as soon as the funding makes its way.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay. Excellent. Yeah. You mentioned loitering munitions among the products that are in demand. Maybe you could talk – and loitering munition is a product where AV was really a pioneer in the market. Can you talk a little bit about how you see that market evolving? I know people – people hear about loitering munitions being manufactured by several different companies. How do you think this market evolves in terms of how many companies can grow and kind of have a decent share in this market, and what distinguishes AV from the competitors?

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

A

So, our history is exactly what you described. I mean, these categories that we're the leader in, is essentially categories, in many cases, that we've invented the category. The term loitering munition did not exist before Switchblade. And Switchblade has become [ph] anonymous (00:04:14) to the term loitering munition in the market. Number one. Number two, we've got the most proven technology in the market. We're producing, in high volumes today, at Program of Record level rigor and certification and safety confirmation levels for those loitering munition, and we're way ahead of everyone else in this category.

The market, however, is large, and as a result of the success of Switchblade, and loitering munition, the lowest end of the market, probably the smallest part of the market is this FPV drones that are – have some sort of explosives strapped to it. That is a 1- to 5-kilometer conflict problem and solution. It's most likely not relevant for a majority of the conflicts that are around the world – that US is going to face. The kind of conflict that we're fighting in Ukraine is very different than what's going on in the Gulf. It's going to be in the Pacific. It's going to be in other parts of the world, potentially. Hopefully not. So, that's one.

Two, in that space that we're in, we're the leader and we're on second or third generation products. We're not only producing in volume, we've iterated and improved this technology multiple times, and we just, as you know, announced Switchblade 600 Block 2. It's the next generation and more capable. We are on Switchblade 300 Block 20, and we've also introduced our Switchblade 400, which is a whole new category for launched effects for it going into other platforms, tanks, armored vehicles, helicopters, airplanes.

And then all – as you get larger, there's also room for larger loitering munitions on platforms such as a Predator or a Reaper, manned airplanes, etcetera, etcetera.

And so, you see a huge portfolio, we have a phenomenal category solution provider portfolio and we're even expanding that with our one-way attack solution such as Red Dragon. And that's another piece of the market related to loitering munitions that is complementary. They're not actually competing with each other. Very different missions for those two.

So, you're going to see more players. The market is growing. It's going to be a multibillion-dollar market. If it's not already today, it's on its way and we've doubled our business last year. We've doubled our production. We're building another plant for a $2 billion-a-year worth of production capacity for Switchblade or other products. That's going to come online later this calendar year, beginning of next fiscal year – next calendar year. And that gives us an additional capacity. And the reason why we're doing that is because we see tremendous growth opportunities here in the next 12 to 36 months.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Okay. Okay, excellent. If we dig into the products a little bit and we think about from the Switchblade 300 going to Switchblade 400 and Switchblade 600, what are the improvements that have been made? How do they – how do some of these improvements address the issue of jamming, for example, to give the product more capability?

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

A

Yeah. So, I think this is a very underestimated aspect of the competitive differentiators that we have in the market. Most of the entrants of new players in this market is like on their prototyping, early, early phase production-level product. And if they have done that, they've never done it at the rigor of the US DoD's safety, certification, operational requirements and logistical footprint and training and all that. We are way, way beyond that in that regard. So, there's a lot to be done for anybody who wants to compete in this market, to make tens of thousands of it that goes into stockpiles with the US Military for a decade or so.

That's a whole different ballgame than making a quadcopter FPV in a garage and using it next week and 90% of it doesn't hit the target. That's not what the US Military is going to have in the stockpile. It's going to go in a stockpile. It's going to stay there for years. And anytime it's pulled out, it's got to work the same exact way it was working when you tested it before this thing. A.

B, improvements. Switchblade 300 Block 20, for example, has a user field swappable warhead. You literally put your thumb inside the nose of the airplane, you pull it out, the warhead comes out and you put another warhead. The other warhead that we've actually certified in that airplane – in that loitering munition is called a EFP. It's a explosive that a airplane – that three of them weighs about 25 pounds and one person can carry. It could penetrate 90% of armored assets on the Ukrainian battlefield.

Essentially everything that the Russians make, except a mean battle tank, can be defeated with a little weapon system that goes this this long, and it's – three of them you can carry in your rucksack. That's a paradigm shift on what type of missions you can do with a Switchblade 300. And that's just one of 20-plus other improvements and enhancements in that product line. Same thing with Switchblade 600 and same thing with Switchblade 400.

And we don't have time to go into all the details, but I'll just give you one little example on one iteration of the Switchblade 300, that is – we're working on those levels of improvements and enhancements, while others are trying to make the first one hit a tank effectively, let alone do all these other missions.

Seth M. Seifman Q

Analyst, JPMorgan Securities LLC

Right. Right. Okay. Okay. When are...

Kevin P. McDonnell A

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

The Switchblade 600 is a maritime capable...

Seth M. Seifman Q

Analyst, JPMorgan Securities LLC

Okay.

Wahid Nawabi A

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

That's right.

Seth M. Seifman Q

Analyst, JPMorgan Securities LLC

You put it on ships.

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

[ph] I think they're perfect (00:09:35).

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

And you could go on a small boat, a boat that is actually moving with a lot of problems in the water. It could take out other assets that are moving on the water and it's got a whole plethora of things, the gimbal improvements are significant, the anti-jamming software and algorithm is significant, the type of radios you can put on it is modular, it can be done. There's a whole list of stuff. It's essentially a next generation product. It's like a next generation car. It's a significant improvement to the old model.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right. To what extent do you find, among customers, that that cost can be a decisive factor in how they buy? And is there kind of a distinction, you think – in the US, maybe there's a little bit more of a capability focus. We want it to do X, Y and Z, whereas when you take products abroad to sell, it – the competitive environment is tougher because cost becomes more of a factor.

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

Yeah, so this is very different than a consumer product, like a laptop or iPhone or iPad. There's a lot of talk about low cost, right? First of all, an FPV that I just described, that costs $3,000 to $5,000 that's used for the mission that I described, is a very small portion of the target TAM or market. We intentionally decided not to play there because we knew that A, won't be a bigger mission set, and two, it's not as relevant and it's hard to make a lot of money in.

The rest of it, we're the cost leader, actually. We're the high-volume producer with the lowest cost and we compete with all sorts of players in every market. Whether it's Pumas or Ravens, or Switchblade, or any of our products, we have not only domestic competitors, but in every international opportunity we have a half-a-dozen, a dozen of the domestic local competitors. So, we can compete on cost very effectively, number one.

Number two, I would say, is that there's a different bar when you talk about the US Military and our closest allies. Those drones that are made in Ukraine, that have all sorts of Chinese parts will never make it into our stockpiles. There's way too many problems with that just on the supply chain alone. The level of – the safety that you have to have to get these things certified to the US rigor is significant high bar. The ability for the performance of the product, size, weight and power, is enormous.

Like one of the most difficult things about Switchblade 300, for example, was to make three of them fit in a rucksack with all the gear that can be launched, and weighs less than 25 pounds and it carries all that mission – all the warhead, etcetera, etcetera. And so that's not an easy requirement when you include all the other things. The book of requirement becomes this thick.

And so, the bar people think, it's like, all right, I'm going to make a lower cost, book, and I'm going to be able to compete with this handbook. That's not this market. This market is years of expertise in the areas building us a moat, a technology stack, and we've been successfully doing it for 20-plus years. We've had competitors from all corners of the world, and we don't usually lose because of cost. We haven't, really. And if you look at our win rate, it's really high in that regard, too.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Okay.

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

Yeah.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Good. So, the opposite side of loitering munitions, you've got counter-UAS. And so, can you talk a little bit about the path to growth? You've got several products here: Titan, Freedom Eagle which is an effector, LOCUST, which is a directed energy weapon, which saw you discussing on Sunday evening on 60 Minutes. Where do you have scale already in your counter-UAS business? Where could you scale quickly if the demand emerged and kind of where do you see – there's clearly high demand for this. How do you see the growth emerging?

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

Sure. So, I'm glad you brought this up because we've lived through it and it's a very crisp and clear takeaway in my view. The Ukraine War was an inflection point for drones, and warfare with drones, and one-way attack and kamikaze drones such as Switchblade and Red Dragon – actually mostly Switchblade. The Iran conflict is – is in my view – and the demand has gone up in the brand, in the awareness, in the need, in the programs and requirements and all that. The conflict in Iran is an inflection point for counter-drones, and counter-one-way attack drones.

We've always believed that this market is going to come in and it's going to lag the market that I just described initially. And I just read a report last week that Iran has launched 1,400 one-way attack drones on UAE alone, in one week. One week. I think two weeks, three weeks ago, the head of the oil business within UAE said this is going to be a catastrophic event for the oil economy of the world. And you're seeing that in the news every day, etcetera, etcetera.

So, my point is that we're at an inflection point. We've always had a multilayered approach to defending against drones and counter-drones and kamikaze missiles. First, the easiest, fastest way to protect is RF jammers that detect and defeat. We have the world's best deployed, successful Program of Record [ph] won (00:15:08) full-rate production Titan series of counter-UAS systems. You're going to see a lot more of that and all sorts of applications.

And the second thing is that just recently the US Government approved the use of those kind of systems for civilian applications of protecting stadiums, music festivals, hospitals, critical infrastructure. That is a massive market. It is not even – nobody's even scratched the surface and that is going to start opening up in the next one to five years. We've got the world's best solution. We're already producing them. We've doubled, tripled capacity. We're going to – we're increasing the capacity of that product up to $0.5 billion dollar next fiscal year.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay.

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

A

Yeah. And it's going to be a significant growth driver.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. And that's just Titan.

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

A

Just Titan series of products for RF jammers for all these applications. The second category – the second layer of defense is directed energy. That is our LOCUST systems. That was in the 60 Minutes news this past Sunday. And why is that important? We – I believe personally that the holy grail for counter-drones and counter-loitering munition and counter-one-way attack is going to be a directed energy solution. For military.

Why? Because military adversaries have – are more sophisticated and these drones and counter-drones are not going to be jammable. They're not going to have dependency on RF communication. When you don't have that, then you have to be able to detect these things and defeat them without having an RF signature. And that's where direct energy LOCUST comes into play.

We've got, by far, the largest moat and competitive differentiators in that category than anybody else that I know of, in the whole world. And we've got the sweet spot solution. There's a Program of Record with the US Army. They're competing it and we're competing on that program. And hopefully they'll have a decision, and that – it's the first-ever Program of Record in this category for the US Military, ever, to buy production-level product.

And the conflict in Iran is basically as poster child of what are you going to do when thousands of these come to you. That thing takes the cost of kill per target from millions of dollars per missile, to $3 to $5 per shot. That economic equation is going to absolutely eventually prevail, and that's the solution.

The third layer is, if those two first layers of defense fail then you use a kinetic kill, and that's where the Freedom Eagle-1 comes into play, which is a little bit further behind in adoption. We've got – we even down-selected with the US Army for Program of Record, it could be as large of a franchise as a Javelin missile. It's the – a very economical system that is focused directly for Group 1 through 3, mostly on Group 3, and eventually even to hypersonic missiles in terms of its market.

And so our approach has always been a layered approach. We've got the best solutions on the first two, and we're developing the best solution on the third, which is another year-and-a-half or two away.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. And is the – do you think purchases from non-military customers on Titan will be coming soon?

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

Really hard to predict the exact timing. I do believe it's going to come. Whether it's going to be in the next three quarters or next year-and-a-half, I believe it's going to continue to pick up, because there is a significant amount of awareness in this area, and I believe that – I hope it doesn't take a catastrophic event for this to happen. But, events such as the World Cup, the Olympics, large stadiums, there's already expertise within these organizations trying to develop solutions and capabilities to defend against these kinds of threats.

And NFL doesn't want to be known for a football game that doesn't have protection against this, or the Major League Baseball, or whatever – you know, I'm just using hypothetical examples.

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

Yeah, and Wahid referred to the law change that allows state police to use the Titan systems, and we've already seen some demand picking up there from the state governments.

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

Yeah.

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

State police.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

And we've seen – I guess it's been reported in the press, some use of the LOCUST by Customs and Border Patrol, or the Army on the southern border. We know that there were some issues there involving the airport in El Paso, but we assume that that has to do with – that was – that doesn't – that involves the system working the way it's supposed to.

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

Right.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

It's just that there wasn't maybe as much knowledge as there should have been about the fact that it was going to be on.

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

Well, the system worked exactly how it was advertised and how it's supposed to work. A drone was in a airspace that it was not supposed to be there. The commander had the decision authority, had to make the decision. It's their decision, not ours. We're not involved in that. We provided a system that said we're going to do X if you ask it to do X. And it did exactly X when it was asked to do X.

The bigger awareness is about the use of directed energy systems in the national airspace. That has been a big, big challenge because nobody's been able to crack this code. We're one of the first players that actually has a system that's now operationally deployable, that could be useful for those use cases. And FAA actually just recently did a test against a manned airplane, where they took our system and they used it against that to see if it is safe.

And there's, first of all, hundreds of safety measures built into the system to begin with, literally over 100. But, beyond that, actually, it proved an FAA test that you are not going to be able to harm a commercial, private manned airplane with the system that we have, in the use cases that we have.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Okay.

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

A

So, I think it's going to open up a significant more – this is a new territory, right? FAA and US Border Patrol and US Army, they all have to work together on de-conflicting. And that's something that is happening as we speak. And that's not the decision that we make. It's our customers.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. I guess maybe two questions about just the stuff that's going on in the world now. I mean, are there opportunities to sell counter-UAS systems quickly to countries in the Gulf?

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

A

Absolutely, there is. So, really right now for counter-UAS RF detect and defeat, the Titan is really not necessarily demand. Its capacity. We are making them as fast as we can. And like I said, we're going to probably do – we've published some numbers as you know. We're significant – we've more than doubled the capacity this fiscal year, and we're taking it up to $0.5 billion dollars' worth of capacity production in this...

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

A

[indiscernible] (00:22:00).

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

A

...which is a month-and-a-half away. And so, I believe that we're going to – that's going to be a very – probably one of the top growth drivers of our portfolio. We have a lot of growth drivers, but that's one of the biggest ones in terms of next fiscal year.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Okay. Okay.

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

And it's also very highly profitable and EBITDA-favorable product line.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Okay. That's a – is that like – that's a fixed price...

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

Commercial item...

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Commercial item with commercial margin.

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

That's right. And that came from the BlueHalo. It actually is [ph] in our segment-one (00:22:32) business in terms of where it exists within our portfolio and reporting, but it actually came from the BlueHalo portfolio.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Yeah.

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

It is the one that is most mature that's transitioned into a commercial product. We're selling it as a commercial item. We have a price list. We are already selling it to a bunch of international customers. It's been publicly disclosed that it's very effective in Ukraine conflict and the market for that is fairly large, globally.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Okay. Other conversations or conversations about other products you may have been having recently, have things picked up with the Department of Defense here, about not just counter-UAS, also whether it's the loitering munitions or drones. And to the extent that we see a wartime supplemental, is that something where you might expect to see some funding for AV products?

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

Absolutely. I'm spending a lot of time in D.C. in this – including this week and next few weeks, because, A, our categories are high visibility, high profile, high importance and urgent, and we've got the best solutions in the market. And then also our system – we're one of the very few companies that can actually produce these by the thousands today. We're doing them today.

We're the volume leader in terms of production capacity now. Not two years from now. Not 24 months from now. So, there's lot, and of course, the conflicts that you see is like poster child of the type of system that you need from AV. And that we make and we've been pioneering these for a while.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Okay. Okay. I wanted to ask you about SCAR. I started covering the stock relatively recently and it seemed like something happened in November, reading about SCAR and the feedback from the customer, and then the stop work order in January, and then subsequently the cancellation last week. Can you talk a little bit about what happened between now and then and how is there a potential path to continuing to work on that?

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

A

Sure. So, I'm only able to comment on it based on what I'm allowed due to our contract and sensitivity to our customers and respect for them. Ultimately, we are a firm, firm believer in this capability, and also in this capability gap. It is of high, high importance and urgency to the Department of Defense – War.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah.

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

A

It is a very high priority for the Space Force and it's a gap that must be addressed. We believe we have a very significant head start than anyone else. This program was competed. We were – we won the program. There's been a lot of scope creep. And we want to make sure that the overall program is successful to meet our – the mission of our military customers in our country.

What we wanted to have is a structure where we can actually develop and deliver this product like a commercial item. That is now really, really attractive to the US Department of War. And so, we sat down to see if we can renegotiate this contract and come to an agreement.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah.

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

A

And there was only two options. You can come to an agreement on the existing contract, or you can cancel and basically restart the program, either way. We believe in this capability so much that we're going to continue to develop the capability as a commercial item on our own investments, because we do know that the market for this is significant.

Every satellite that we have in – geosynchronous satellites in space, including even non-defense satellites, is going to need this capability. You've got a parabolic dish right now talking to a satellite one at a time, and it's limited in bandwidth, limited in capacity, it's vulnerable, etcetera, etcetera.

Our Phased Array BADGER system allows you to talk to multiple satellites, up to 20 at a time, and you could do it simultaneously with higher bandwidth in multiple bands, and you could do it such that you could point – without pointing the dish, you just point it digitally with electronics. It's basically a satellite dish in a chip instead of a dish and the improvements and performance is massive.

Eventually, all the satellites in the world that are geosynchronous and even MEO-synchronous satellites are going to take some of the systems like this. So, that's why we believe in the fundamental problem and the fundamental solution or architecture.

While we do this, the government may recompete, will recompete, they've said that publicly, and we are going to absolutely compete for that. But, we hope that we actually develop this ahead of all that and deliver a solution off the shelf and the customer can buy and the whole thing is solved faster.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right. Okay.

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

It was about 5% of our revenue last year. We're still going to have a strong growth this year. We're still expecting to have double-digit growth next year. It's going to be less than 5% of our revenue going forward. We wanted to get this all cleared so the story is behind us, and we move forward with all the other exciting growth stories that we have in our business.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

And the – when you were saying the growth next year, you meant for the company as a whole, or you were talking about SCAR?

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

No, company as a whole.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Okay yeah, of course...

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

Like I said, we have so many shots on goal...

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right, right.

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

...that are very large potential growth opportunities.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Yes.

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

SCAR is just 1 of 10 or so. And we wouldn't expect SCAR to grow that fast immediately anyway.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Right.

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

And it wasn't a massive revenue contributor either.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Okay.

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

Yeah.

Seth M. Seifman
Analyst, JPMorgan Securities LLC
Q

Okay. So, when you think about the write-down that you took in the quarter last week, to the – does your future success on, whether the program is called SCAR or something else, but on delivering that capability, might there be further write-downs depending on how that goes?

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

We don't think so. I mean, it really relates to the whole Space business, not just the SCAR program. So, we – we've had a lot of positive developments on long-haul laser communications, we got a $500-million contract there. That business also includes what we call gun sights business. So, that's a replacing the pointing and tracking capability on existing armored vehicles, is included in that business model. So...

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

PANTHER.

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

A

And PANTHER, the phased array hypersonic missile tracking system is in that portfolio. So, there's a lot of things in that portfolio that we feel very good about. It's just – when you just – when the event happens, the auditors pull out their spreadsheets and start evaluating the cash flows. And it just so happens, there was a little bit of a shortfall. It wasn't really that significant. The total value of the asset was $3 billion, and the write-down was $150 million or so..

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Non-cash.

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

A

Non-cash. Right.

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

A

Non-cash entry into the balance sheet.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yes. Okay. Okay. You mentioned optical communications technology. How should we think about the scale of that opportunity and kind of what happens next there? That seems to be a pretty critical technology as the Space Force thinks about building out the architecture that they want.

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

A

So, again, we have so many exciting things, it's hard to talk about every one of these and give it enough merit of its own doing. Most companies have one or so – one or two, maybe max, and we've got like a dozen of these things. Laser communication, so we talked about BADGER being this RF communication phased array that revolutionizes RF communication with satellites. But even that needs to be complemented or supplemented with a laser system because RF systems are all jammable. And so, you do not want to rely on one way of communicating to these billion-dollar satellites.

The next generation evolution is to actually have optical laser communication from the ground to these satellites. A, it's much, much more non-jammable. And two, it has got a much, much higher throughput of bandwidth. And we won a Program of Record basically with the US Military to develop and deliver and progress the program which we have we – we call the Laser Communication Terminal.

We've got the technology that allows you to actually hit a satellite halfway to the moon from the ground. That technology is in – that's 250,000 kilometers out. And so, it is the Holy Grail again, long-term, for satellite communication to the ground. And we are – and the secret sauce that is in our BADGER system, in our LOCUST system, is in our laser gun sight is very similar to what Kevin had described here, which is the ability to track and hit the target at long, long distances. And that's something that's not easy to do.

Everybody is focused on more power. It's like giving somebody more bullets, but they don't know how to hit the target. Doesn't help solve the problem if you can't aim. The most important thing is solve the aiming problem. Then I can give you more bullets to kill more targets – hit more targets.

And so, our ability to hit a small – give you an analogy how precise and how accurate this is. A laser pointer that we have in here, for example, imagine pointing this to a strand of human hair about a football field away from you with your human hand.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Wow.

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

A

Yeah. So, you got to have the precision to be able to put that laser on a strand of human hair at a distance of about a one football field. We've got to hit a satellite dish at 70,000 kilometers, 80,000 kilometers, 100,000 kilometers out in the space, from the ground while the satellites are moving and the earth is rotating. That's the technology that makes it so unique. And I do believe that in the next five years, a significant more funding and acquisitions will happen in this area specifically.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay.

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

A

Yeah.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Excellent.

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

A

And we're the leader in this space, by the way.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah.

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

A

Yeah.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Yeah. And I know it's a place where people have been trying, for a while, to make progress. The piece – when I think about the BlueHalo merger and the company that came in, thought of it as like a kind of stable piece and a growth piece. And we just talked about kind of the growth pieces as Space and Direct Energy.

The more stable piece was kind of Cyber and Mission Systems. That business seems like it's headed for maybe $350 million-ish of sales this year, ballpark, but we have seen some pressure. Can that Cyber and Mission business maintain that level of sales going forward? Is that kind of how people can think about it? Is there – is there further pressure on it? Can it return to growth?

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

A

Yeah.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

What's sort of the profile there?

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

A

Yeah. So, by far, the biggest value driver, as part of the acquisition of BlueHalo, was all these pieces that I described that are long term. The strategy has always been to bring these very complementary set of solution sets to make a portfolio that really solves all my customers' missions better.

Cyber, we've always said it's not going to be the fastest growing. It is also the one that got hit with the DOGE activities at the beginning of the fiscal year, the administration. We have a baseline. Yes, $350 million is very doable, number one. Number two, we expect that actually to grow going forward. It's just that the growth is not as explosive as the other categories.

We've always said that. We maintain that. We're doing – it's a – it's absolutely a high mission-critical set of cyber security operations that we do, that's both offensive and defensive that is really unique and desperately needed in our military and our intelligence community. So, we believe that this is important, but it's not high growth. It's going to grow, but very slow single digits.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Okay. Okay. We're getting close to the end. So, maybe if we can sneak in one more. Just when we think about the expectation and the cash flow expectation for the year, we've seen some working capital growth year to date. You know, what gives you confidence of being able to liquidate that here in the fourth quarter?

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

A

Well, this year we had a lot of growth in our Switchblade and loitering munitions business. So, that's significant growth and at the same time – and that's probably the main driver of the working capital growth through the year is that business. We also, during this year, had some product transitions and new products, specifically as Wahid was mentioning earlier, the Switchblade 600, and Switchblade 300 went to new generations, and that just caused a little bit of a logjam in our unbilled receivables. And that all seems to be behind us now.

I think we'll see some good progress in the fourth quarter and – but not all the way there, but then in the successive quarters start to see that unbilled coming down for that business.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Right. Okay. Okay. Excellent. And with that, we're at time. So, yeah, no, this was very informative and we appreciate both of you being here. Thanks very much.

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

Thank you so much.

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

Thank you.