

FINAL TRANSCRIPT

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TASR - Q2 2009 Taser International, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good day ladies and gentlemen, and welcome to the second quarter 2009 TASER International conference call. My name is Shamisa, and I will be your coordinator for today. At this time all participants are in listen only mode. We will conduct a question and answer session toward the end of this conference. (Operator Instructions) I would now like to turn the presentation over to your host for today's call, Mr. Rick Smith, Chief Executive Officer of TASER International. Please proceed sir.

Rick Smith - TASER International - CEO

Thank you. Good morning everyone. Before we get started I'm going to turn over to Dan to do the safe harbor statement.

Dan Behrendt - TASER International - CFO

Thank you. Certain statements contained in this presentation may be deemed to be forward-looking-statements as defined by the Private Securities Litigation Reform Act of 1995, and TASER International intends that such forward-looking-statements be subject to the safe harbor created thereby. Such forward-looking-statements relate to expected revenue and earnings growth; estimations regarding the size of our target markets; successful penetration in the law enforcement market; expansion of product sales to the private security, military and consumer self defense markets; growth expectations for new and existing products; expansion of production capability; new product introductions; product safety; and our business model.

We caution these statements are qualified by important factors that could cause actual results to differ materially from those reflected by the forward-looking-statements herein. Such factors include, but are not limited to, market acceptance of our products; establishment and expansion of our direct and indirect distribution channels; attracting and retaining the endorsement of key opinion leaders in the law enforcement community; the level of product technology and price competition for our products; the degrading rate of growth of the markets in which we compete and accompanying demand for our products; potential delays in international and domestic orders; implementation risks of manufacturing automation; risks associated with rapid technological change; execution implementation risks of new technology; new product introduction risks; ramping manufacturing production to meet demand; litigation resulting from alleged product related injuries and deaths; media publicity concerning product uses and allegations of injury and death, and the negative impact this could have on sales; product quality



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risks; potential fluctuations in quarterly operating results; competition; negative reports concerning TASER device uses; financial and budgetary constraints of prospects and customers; dependence on sole and limited source suppliers; fluctuations in component pricing; risks of government investigation and regulations; TASER product tests and reports; dependence upon key employees; employee retention risks; and other factors detailed in the Company's filings with the Securities and Exchange Commission. With that I'll turn it back over to Rick Smith, our CEO.

Rick Smith - TASER International - CEO

Thanks Dan. This has been just one exciting week for TASER International. We're holding our annual conference and we have unveiled the new TASER X3; that will be looked back upon as a big a revolution in non-lethal weapons as when firearms went from the muzzle loader to the revolver. We now have a multi-shot capable device with all sorts of additional data capabilities, and I've spent the last several days out with police officers, training officers from around the country, and they're saying we just nailed it in terms of the product features and technology.

Not just the X3, we're now shipping the wireless XREP projectile, where now for the first time non-lethals can really start to go head to head with lethal bullets in terms of range, multiple target capability, with the effectiveness of TASER, yet without all the unintended consequences of traditional firearms. The Shockwave is now shipping, our area denial system; AXON and EVIDENCE.COM that we believe will revolutionize the way police deal with digital information and the ways to collaborate together. That system is no online, but moving into a beta phase, so you don't expect to see any revenue impact this quarter. We may begin to see revenues next quarter and early 2010 as that part of the business starts to scale.

But what you're seeing now is the result of the heavy investment spend we've made over the last few years. Not only do these open up big new potential market opportunities for us; I'll just start with the most obvious one, the TASER X3 gives us an opportunity to go back and to have an upgrade cycle in our core business. Just to put some color on that, we have an installed base of 425,000 single-shot TASER devices between the M26 and the X26, we believe there is an opportunity, and we have an aggressive trade-in program to promote that, that could generate up to \$600 million in revenue opportunity just from upgrading our install base from single-shot to multi-shot. So obviously that's got me excited as both a businessman and as a technologist where the Company is.

So with that let me go back into some details now about the quarter, and then we'll come back and we'll end with the big picture again. For the second quarter our revenues were \$21.8 million, so up 3.5% over the same quarter last year, once again proud that our team was able to achieve some growth in the current economic environment. But, and you've heard me say it before, what doesn't kill you makes you stronger. These are the times that give companies like us the ability to extend our lead, that's why we've been making heavy investment spend. We've got our eye on the future but we're executing well in the present as well. This Dan will talk about.

We had, I think, some pretty good success in terms of SG&A cost controls this quarter, and other things we're doing, to make sure we're optimizing the present while we're building for the future. Our research and development expenses were \$4.4 million, up 45% over last year, driven by the intensive fulfillment efforts on the near simultaneous launch of the TASER X3, TASER XREP, and AXON and EVIDENCE.COM moving into pilot phase.

Something that I would keep my eye on, the operating income before research and development, and extraordinary expenses, again the reason Dan and I looked at that number is basically we consider R&D an investment in our future, and then take out extraordinary expenses that are not indicative of ongoing operations, the operating income before those gives us a good idea of how we're operating our core business before we think about -- it sort of bifurcates the concept of investing in our future with R&D from current operating results.

On that basis, the quarter was \$2.9 million to the positive, which is up 13.4% of revenue versus \$3.9 million last year, which was 18.5%. And Dan and I were talking about why this year is lower than last year after we take out R&D, he did point out to me that



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we also still included in this number are the FAS123R stock option expenses, and as we've become more of a tech company, meaning we've built out an entire software development, world class software development team both in terms of executives and execution talent in California, options have become, and will continue to be, a larger part of our compensation expense.

My personal opinion in that I was never a big fan of stock options because I think it distorts the view of what's really going on, but that's neither here nor there, because I'm not accountant. But I just thought I'd point out that from modeling perspectives we are seeing the type of talent that we're hiring, and the environment we're competing in now, in the software and service space, we will have higher 123R charges as well. So that's the primary reason that we see operating income before R&D as lower than it was last year.

All right I've dwelled on that long enough, let's move on. So net message is I'm very happy with where the operations of the Company are today, and I believe we are firmly planting our feet to make some bold moves that you're now starting to see unfold. So as I mentioned, on June 30 we announced that the wireless TASER XREP shotgun rounds are now shipping. You'll see posted on TASER.com, you can go later today and view the keynote address from Monday, you'll see Tom and I were handing out live rounds to some of the police that were there. They were pretty darned excited to get them, and the TASER X12 less lethal shotgun by Mossberg is also now shipping.

International sales have grown this year, they were 17% of total sales for the quarter, up from 12% last year. They were down a little from 37% in the first quarter where we had some significant orders in the first quarter, particularly the large UK orders, but we're continuing to see growth opportunities internationally and the adoption of TASER continuing to expand.

Seven more product liability suits were dismissed during the quarter, so as of the end of the quarter we had 91 wrongful death or injury suits have been dismissed or judgment entered in our favor. Also, there's a critical new medical study that was released by Hennepin County Medical Center in Minneapolis that looked at catecholamines in simulated arrest scenarios. Now this is really important, as you all know we did have our first litigation lost last year in the Heston trial, and the theory in that case came to us, I'll just refresh your memory, the jury found that they believed TASER was 15% responsible for the tragic death of Mr. Heston, who was 85% responsible for his own demise due to toxic methamphetamine use. But the theory that was put forward was that the TASER caused stress and/or muscle contractions that led to changes in blood chemistry that were bad. It was the straw that broke the camel's back theory.

This new study out of Hennepin County, what they did is they compared several different types of arrest scenarios; in one case they had officers punching a heavy bag for 45 seconds to simulate a struggle with police. In another they had people run 200 meters to simulate running from police; in another case they had them run, I think, 20 meters and then fight briefly or be attacked by an attack dog, while wearing a padded suit of course, they did pepper spray and then they did the TASER device. And what they found that was remarkable was that by far the most dangerous changes in blood chemistry, both in terms of catecholamines, which are the stress hormones like adrenaline, and in acidosis, which is basically exhaustion, the most dangerous things from this study, number one far and away was the 45 seconds fighting with the heavy bag. In fact we're not -- most people don't think of this, but when you're really fighting all out at full strength, 45 second you're beginning to reach exhaustion, and half of the subjects either vomited or passed out after that exercise. And their blood chemistry changed dramatically, PHs dropped very close to the critical zone where you start seeing risk of significant health problems. By comparisons, the TASER exposures had very minimalist impact on those hormones and on the blood chemistry.

So this is going to be a really critical study, because it actually shows that from this theory of "the straw that broke the camel's back" that the TASER is frankly much less dangerous than a continued physical struggle or someone running from the police in terms of the stress it puts on their own system. So that's going to help us a lot going forward in terms of setting the record straight and defending against similar theories in the future, that once again, science is pretty solidly on our side. So with that I'm going to go ahead and pass off to Dan to give more detail on the financial results of the quarter, and I'll be back again.



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Dan Behrendt - *TASER International - CFO*

Okay, thank you. Sales for Q2, as Rick said, are \$21.8 million, which is up \$732,000 from the prior year, mostly driven by the Company's international sales. Sequentially our sales are down \$2.8 million from Q1, but again that's caused by the high international sales we had in the first quarter where we had the large orders from the United Kingdom and Brazil, which together with other international orders contributed \$9.1 million of international sales, or 37% of the total.

The international part of the business has always been lumpy and characterized by large orders, each time difficult to forecast. I can say that we had a distributors summit over the weekend, we had 29 countries represented at our distributors summit. So we continue to have very strong relationships with our international distributors, and they see sort of the potential in our products, especially with our expanded product lines we're starting to roll out now.

Gross margins of \$13.7 million or 62.9% of sales are down 1.6% as a percentage of sales from the prior year. The decrease in margin is mostly driven by lower capitalization of overhead in the inventory, primarily due to lower finished goods inventory, which caused us to absorb less of our fixed costs. Sequentially however margins did improve 3.4% from the first quarter, most of this was driven by the change in product mix from the first quarter where we had a much higher percentage of sales coming from cartridges, to this quarter where we had the normal mix where the X26 and other handheld devices had a much larger percentage of our total sales, which helped to drive up our gross margins. We also had a similar amount of overhead capitalized in inventories this quarter, where last quarter we saw a decrease from the end of the year, so that certainly helped to kind of stabilize the margins.

The AR \$14,000 increase in direct manufacturing expenses, as you can see, versus the prior year, again the biggest driver to that is that absorption of the fixed costs into inventory.

The SG&A expenses of \$10.8 million for the quarter versus \$9.7 million in the prior year, the increase is driven mostly by higher salaries and benefits of \$215,000 due to increased headcount as we built out our management team and hired support for the new product lines. We also saw our 123R charges for stock compensation go up \$535,000 from the prior year; and consulting was up about \$450,000 as well. As you can see from the prior year, we had the \$5.2 million punitive damage reward for the Heston case, which we recorded, that was actually thrown out by the judge and reversed in the fourth quarter of last year. But you can see it certainly had an impact on the second quarter of 2008 results. Sequentially SG&A expenses are down \$632,000 due to lower outside legal fees, lower accounting fees; we really worked on trying to cut our discretionary spending in order to allow for better profitability in the quarter.

I will say that as we move into Q3 we may see that trend reverse itself a little bit, we've got, obviously, loan costs relating to the X3, AXON, XREP and Shockwave products that will hit this quarter. We also have our TASER conference this week, which is a significant expense. But certainly we're working hard to pull in those discretionary spending and try to drive profitability.

R&D expenses of \$4.4 million in the second quarter, this is an increase of \$1.4 million over the prior year. Again driven mostly by higher salary benefits and 123R charges of \$1.4 million to support both the hardware development of our new products and the software development team that we've got in California. We also have increased tooling and supply costs of over \$600,000, mostly due to costs associated with the working prototypes of AXON, XREP, and the new X3 handheld device.

We did capitalize about \$650,000 of the software development costs this quarter for EVIDENCE.COM. And sequentially, we saw that R&D is up about \$200,000 from Q1. Again, that's driven mostly by the indirect supplies and tooling for the prototypes for the new products, which we are introducing this quarter.

We do expect the higher R&D spending to continue through the rest of this year. Certainly, as these products to go market, we've got some [development] engineering we need to do and to make sure that we can maximize profitability of these products and make sure that we've got the quality and manufacturability of these products as they move into the market. We do feel



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very good about the new products we've introduced. We think we certainly have lots of new differentiated products, which will better position us for the future.

And on a non-GAAP basis, the cash income from operations was \$679,000 when you add back the 123R depreciation and amortization expenses. And we feel, as Rick mentioned before, it makes sense, to look at our operating account on both a cash basis and also traditional GAAP basis, because of the significant amount of non-cash charges that are the result at this point.

On a GAAP basis, just to close it out, we had a pre-tax loss of \$1.5 million and a net tax loss of \$723,000, a \$0.01 per share, on both a basic and diluted basis.

Back to sales for a minute here, I just want to give you the units for the quarter. We did sell 15,275 X26. That's up about 1,900 units from Q1, which helped contribute to the higher gross margin this quarter. We sold 232 M26s and 300,096 cartridges, which is down from Q1. We had this unit's (inaudible) cartridge order from the UK. We sold 3,863 C2 devices and 2,345 TASER cams in the quarter.

Moving on to the year-to-date sales, we had year-to-date sales of \$46.4 million. This is up \$2.8 million, or 6.5% from the prior year, mostly driven by the increase in our International business. In addition, we currently saw a sequential increase in our domestic law enforcement business in Q2. We're up about \$2.5 million over Q1, which is certainly something that is a good sign for us.

We also had a real strong month of June. So we saw kind of the budget flush that we've typically seen in prior years. We really didn't see that in June of last year or even in December of last year. So the fact we're starting to see higher sales at the end of these quarters that relates to fiscal year-ends for our customers is a good sign that the customers are finding some budget dollars at the end to purchase our products.

Gross margin up \$20.4 million, year-to-date, up 61.1% of sales, which is up .6% of sales from the prior year. We saw about a \$1.7 million increase in direct manufacturing expenses. Again, that's due to lower absorption capitalization of plant overhead, due to lower finished goods inventory levels. And this is partially offset by lower salaries, benefits and warranty charges in the results here.

R&D expenses are up \$3.5 million, driven by higher salaries, benefits and 123R charges for the headcount added to support the hardware developments for the new products, as well as EVIDENCE.COM.

The net loss for the year is \$1.2 million, or \$0.02 per share on both the basic and diluted bases. And one of the things I want people to think about as they model the rest of the year, Rick mentioned the X3 and there's going to be a generous trade-in program for that. As people model out the rest of the year, that will have an impact.

We're working through the accounting on this but we expect to defer anywhere from about \$225 to \$275 out of every X26 sold in Q3 to reflect the value of the trade-in right for the X26. Our expectation is that the program's going to end at 12-31-09. So, whatever we defer in Q3 will get reversed in Q4 to the extent that our customers have not taken up that trade-in right but because we sell between 12,000 and 16,000 X26s each quarter, the accrual for Q3 could be pretty significant.

We felt we did need to offer the trade-in program for agencies, even for current purchases. We didn't want people to not buy X26s in the current quarter while they evaluate the X3. So, we felt that it was a worthwhile endeavor to offer that. We'll also offer it for prior purchases of the X26. So, there's no accounting on that. We'll record any trade-in values as the sales allow us as those programs and sales happen.

On the balance sheet, we ended the quarter with \$52.8 million in cash and investments. This is an increase of \$3.4 million over the 12-31 balances, mostly driven by cash from operations. Due to the uncertainty of the market, we continue to keep our investments very liquid.



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Accounts receivable of \$13.1 million is down \$3.7 million from the prior year balance of \$16.8 million. It's mostly driven by the large UK order received right at the end of 2008. Our DSO did go up a little bit in the quarter but that's really driven by the strong sales we had in the month of June. Actually, when I looked at our AR balances, we had 70% of our AR as actually current, meaning that it's not even due yet. So we had real strong sales, especially in the second part of June, which is encouraging.

Inventory of \$11.7 million is down \$1.8 million from the prior year-end balances. This is driven by some of the significant international orders we had in Q1. It allowed us to bring down some of our inventory. We did expect that inventory would go up a little bit in Q2, which it did as we replenished our safety stocks. And we'll probably see a further increase of inventory in Q3 as the initial raw materials and finished goods to support the newly introduced X3 end of the product lines are added to our inventory. And we had pre-paid and other assets of \$2.6 million, which is flat with the year-end balances.

Our property and equipment investment in those assets at the end of the quarter here is \$31.6 million. That's up \$4.5 million from the 12-31 balance. Some of the bigger drivers on the CapEx side are the products payments on our automated manufacturing equipment. We've got new IT equipment here in Scottsdale. We also purchased equipment to outfit our first EVIDENCE.COM datacenter. So there are some fairly significant expenses relating to those assets. And we also purchased [tooling systems] (inaudible) for the new products in the pipeline. Total assets at June 30th were \$133 million.

Moving onto the liability side of the balance sheet, we had cash payable of \$5.6 million. This is up \$1.7 million from the prior year-end, mostly driven by differences in just check runs from the year-end, versus end of the quarter and some increased purchasing activity we're seeing for the manufacturing activity, as well as some of the datacenter equipment that was purchased at the end of the quarter.

[Accrued] liabilities of \$3.8 million are down 46%. This is driven by some differences in the accrued expense; there's nothing significant there. And the current deferred revenue of \$2.7 million is up from the prior year-end, mostly driven by more extended warranties being sold. The total liabilities is \$18.9 million and we finished the quarter with \$114.1 million of stockholder equity. And we continue to have no long-term debt on the books and a strong cash balance, which gives us plenty of liquidity to operate the business as well as to fund our R&D efforts.

Moving on to cash flows, the company did have cash provided from operations of \$8.1 million for the six months ended June 30th. This compared to a cash used in operations of \$321,000 from the prior year. So, a significant improvement from an operating cash flow perspective.

The big drivers for that are reduced accounts receivable of \$3.7 million, lower inventory, \$1.7 million. We've got non-cash for 123R charges at \$2.8 million; that's a pretty significant add back for us. And we had depreciation and amortization of \$1.5 million.

We did have net cash used by investing activities of \$2.3 million. Again, this is driven mostly by the purchase of fixed assets of \$4.6 million, partially offset. We had one of our investments, a \$2.5 million investment that was called. So, that generated some cash on the financing side.

The Company ended the period with \$52.8 million in cash, which is up \$19.8 million from the June 30th, '08 balance. And certainly, we feel very good about our liquidity situation.

So with that, I'd like to turn the call back over to Rick Smith, our CEO.

Rick Smith - *TASER International* - CEO

Great; thanks, Dan. One question I've gotten from a number of folks, they're asking how does, in the current economic environment, how is TASER going to sell to these agencies that are struggling for money? And there are a couple of answers.



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In fact, I was just seeing this morning on Fox News, there was a story about the billions of dollars of stimulus money that's being released to state and local.

So, federal funding is up tenfold over last year, which should help to make up for some of the budget shortfalls. But as we presented at our keynote this year, TASER devices are one of those investments for a city that can pay for itself very quickly.

We use two case examples I'll share with you here. The Houston PD recently reported to us that their worker compensation claims for cops being injured on the job fell from \$2.2 million the year before they introduced Tasers, to under \$200,000 in 2007. So there was a \$2 million decrease, which, basically, is a savings to Houston of \$500.00 per officer per year in reduced worker compensation claims for cops getting hurt on the job.

Now, another study came out of the Michigan Municipal Risk Management Authority to the big insurance pool in Michigan. It covers 150 agencies with 6,000 officers. They began investing in Tasers in 2003 by reimbursing half the cost for agencies that would deploy them. They just released the results that have shown that, in 2003, when they started this program, they spent \$7 million on excessive force claims. In 2008, that number dropped from \$7 million to \$366,000, a 95% reduction. So, the net effect is that the MMRMA is seeing a \$1,000 per officer, per year savings in excessive force litigation.

I'm going to pause here for just a second because, with some of the controversy that's happened in the media, in the Braidwood hearings up in Canada recently, there is this misperception that Tasers increase litigation risk.

In this [municipal] group here in Michigan, it has reduced litigation by 95%. In fact, if you look at it, Taser claims over the six years that they've been in the field there, represent less than 1% of their excessive force claim loss reserves.

Or, if you look at the cost per claim filed, your average use of force claim cost the MMRMA \$56,000. Claims that involved TASER cost, on average, \$9,000. So, again, significantly less cost on a per unit basis. So the point is, if we add up just these results in workers comp savings and excessive force savings, litigation savings -- and by the way, the reason we're quoting from different agencies is, unfortunately, you never get one agency that tracks everything that you could add it all up. So, these are not mutually exclusive.

You know, agencies where their cops are getting hurt less are probably also getting sued less.

So right there, you're at \$1,500 per year, per officer in savings. We believe this data could be extremely compelling. It will be a major part of our marketing message at the International Association of Chiefs of Police. And, when you look at the cost of a new TASER X3, which is about \$6,600 for agency purchases, and that's before trade-in credits, and trade-ins on X26s will run between \$300.00 to \$800.00, between now and the end of the year, this also tends to create a meaningful incentive for people to use stimulus dollars towards upgrading to a multi-shot TASER.

But even at full price, these devices pay for themselves in the first year. And that's just on the two factors that we've talked about. We haven't talked about other costs of suspect injuries, internal affairs complaint resolutions; lethal force, in terms of, well, just the human cost of -- like, plus the PR issues and things agencies have to deal with.

So, I just thought it'd be helpful to share some of that in terms of how we're approaching the financial times, that TASER's not just a cool piece of equipment; it's a stunning return on investment. In fact, if we go back to that MMRMA, the Michigan Municipal Risk Management Authority, they have spent about \$300,000 reimbursing their agency customers for purchasing Taser devices. Over the six years, they've saved almost \$18 million in lower excessive force claims. So, that's about a 6,000% return on investment, which we know they're pretty happy with.

All right, so let's talk a little bit more about the X3. As I mentioned before, it gives us an opportunity to go back and address our installed base. And with any technology, frankly it's usually a little easier to go back and upgrade people who already see the value, the technology, than selling new customers who never knew they needed it before.



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And we have an installed base of 425,000 units. So, zero the numbers. There's a \$600 million upgrade opportunity and we're going to be aggressively going after them, with these trading credits between now and the end of the year to see what we can do, what percentage we can get to upgrade pretty quick.

I'll tell you, the officer response has been phenomenal. These cops we've found out] are like kids in a candy store walking around with the new X3, they love the features, the design. For those of you that haven't seen pictures, go to TASER.com. Not only is there a ton of technology, but it's just a beautiful looking weapon, very well designed. So a couple of real advantages, we can now deal much more effectively if an officer misses or there's multiple subjects, they can reengage immediately.

It's again like going from a muzzleloader to a semiautomatic. We've added a warning arc, which interestingly enough, out in the United Kingdom they track very carefully their data, any time the TASER comes out of the holster they have to write a report. Well with that level of data they've shown that more than 80% of the time when a TASER comes out of the holster and they how the electric arc, or they put the laser site on the subject, people give up, which is what everybody wants. We don't want them to fight, we want them to give up.

In fact there was a story out of New Zealand, I was talking to our distributor last night, that because they have not yet rolled TASERs out nationwide there was a man with a knife in a standoff with police. He would not give up, he was threatening to hurt anybody who came near him or to harm himself. They flew a TASER in on a helicopter, it took over an hour to get the TASER there. The officer shows up on site, walks up with the TASER, explains he's about to use it, and the subject says "I don't want anything with that", drops the knife and gives up. So those are the types of resolutions, those are the ones we like best, because those don't end up in the newspaper, and they don't end up in court.

So with the X3 we've added the ability where now the device can arc while it's loaded, so you don't have to unload the TASER to show the warning arc. It may seem a bit nuanced to folks on the phone here, but it's a huge advantage to the officers. Nobody likes unloading their weapon in the middle of a confrontation. Now we can get the benefit of the visual arc and not unload.

We've also waterproofed this device; the X3 will be salt, fog, and certainly rainproof. We're still doing final calibration as to full water submersion, but when it's really dialed in here, in a couple of weeks, we expect it will be submersible in water for short periods of time as well.

In terms of the data and information, this device has a built in calibration system that records the electrical output of every pulse, and then we adjust the next pulse, so we have a very specific target of 63 microcoulombs of charge, not that that should mean anything to any of you, other than the fact is this device calibrates every pulse so that it is precisely delivering the charge we want it to, and we can download that information. And we can also use that information to tell characteristics about what it was shot into. Sometimes there's disputes about whether the police officer actually hit the subject or not, and if they did, for how long. We can look at the graph that the X3 generates and tell for how the electricity was applied, when it was arcing into the subject, and if they missed we can tell that as well. And we can feed that information back to the officer on the new color screen on the device.

So much more information intensive, and the X3 is fully integrated with EVIDENCE.COM. So as you all know we're in about between 14,000 to 15,000 police agencies. EVIDENCE.COM is an enormous opportunity for us in that not only is this a recurring revenue opportunity for the core service, we have a free version of EVIDENCE.COM for handling TASER device data like the X3, the X26 and TASER CAM. The X3 will only download to EVIDENCE.COM, it is more secure than allowing folks to download to a local desktop. So it's a free service, the cops love it, but it's, as all of you are probably also aware, it's a great way for us to build traffic and momentum to EVIDENCE.COM, brining agencies online with the X3 and then around October we'll be launching the free version of EVIDENCE.COM that supports the standard TASER X26 and TASER CAM. As we get more and more people on EVIDENCE.COM there will be the ability to then upgrade them to the full paid version with AXON and the full digital evidence and video management we believe will really help with our sales cycle. And once those agencies are on there, much like with YouTube, the content drives the value of the network. You go to YouTube because that's where all the content is. Well in law enforcement we're building a secure YouTube analog for digital evidence management where agencies will be able to share



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and collaborate as well. So of course the more agencies that get on the network the more valuable the network becomes for the incremental agency, and of course the higher the barrier [inaudible] for any potential competitors long-term. So we're very much focused on the first mover advantage.

We've also added a three laser sighting system to improve accuracy on the X3, and finally, enhanced safety. Because we are measuring every pulse we can dial in very specifically how much energy goes in to the subject. So that improves the safety margins over our prior devices. I like to characterize that, well the best way is like a 1999 minivan, very safe with the crumple zones and airbags and all that. Is a 2009 minivan even safer? Sure, it's got side airbags now and there's been more technology advances. So the X3 again we calculate has got about double the safety margin of the X26. We've also chosen some new charge diffusion probes that you can learn more about on the website at TASERX3.com. I won't get into too much detail.

But the data capabilities and the safety, and the transparency of being able to report across a whole fleet of TASER X3s is very responsive to where we see public policy going in the debate with TASERS. So the X3 better fulfills some of the recommendations coming out of these public policy groups. And we believe it will also help answer some of the questions about what really happened.

So if we think about it, X3 and AXON and EVIDENCE.COM, all these systems are a breakthrough on their own. But when you put them together they provide an integrated system of capabilities, because the X3 actually even has a wireless communication pack that's optional. You replace the battery with a rechargeable battery with a built in wireless card. The X3 and AXON can now communicate to each other for time synchronization, event triggering, so the when you turn the safety on, on the X3, it will automatically start the AXON recording. And then EVIDENCE.COM provides our unified comment center, taking the data from these devices, and from ever third party devices, including things like fixed cameras, and we can integrate that together using advanced geospatial mapping technology to give police a real situational awareness of what's going on in their jurisdictions.

So because these devices are designed to work together, we're actually launching a new strategic program we call the Advanced Technology Officer, or ATO. An Advanced Technology Officer, it's sort of an analog to future combat systems in the military, where ATO is an initiative to revolutionize the capabilities of the modern law enforcement officer. And we're partnering with folks like Mossberg in building the X12 launcher; we're partnering with a number of different holster manufacturers and accessory manufacturers to build out accessories to modernize the police officer with these new capabilities. There will be more on that as we roll in later in the year, and as AXON moves from pilot trial into revenue you'll see bundled pricing and promotional programs for agencies that deploy the full integrated system as opposed to just buying the individual parts.

So not only do these things create new capabilities, it actually creates a feedback loop, and this is really resonating with the officers we've talked to. So if you think about it, our ECDs improve tactical performance; so to the cop on the street who's dealing with a bad guy, our electronic control devices allow him or her to do their job better, lower injuries, more effective ability to get that person under control. Now if that case moves into the court system, which is what happens in our country, it's not about street justice, we don't just resolve it in the street, that's where it starts then goes into the courts. Well with the AXON's ability to record exactly what happened, we improve the legal performance of the agency and the court system. So now they're able to show an audio/video account of exactly what happened, recorded from the officer's point of view. So this allows the agency to better defend its officers actions, to rapidly dispose of false complaints, and to better prosecute criminal activity recorded into digital record.

One other thing I should actually point out, there are some bad apples out there in any business; and one of the challenges for law enforcement is unless they have extreme definitive proof of an officer doing something inappropriate, firing government employees is extremely difficult. And I've talked to many officers who say, "You know what, there's the 1% out there that make us all look bad. We'd like to get them out of law enforcement into another job." Well with AXON if the officers are doing something wrong, we're going to know that too. So it's actually going to help agencies better perform their jobs by not only improving the performance of their officers, but if their officers just aren't hitting the performance levels required, it's going to make it easier to make the change that I think everybody wants, which is get bad cops off the street, and let's make the good ones better.



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All right, so with TASER and AXON so far we've talked about individual incidents and cases. But where we are unique with EVIDENCE.COM, the real breakthrough is we can provide a global strategic view. We use geospatial mapping technology to fuse thousands of incidents into a strategic map so that now police commanders can see the big picture. They'll be able to look at a map with all their incidents plotted on it, they can do filters and searches to concentrate on different types of crime, map that against where their officers are going based on the GPS in the AXON. It is a sort of command and control system, the analogy I use is what GPS did for the armed forces of the United States in Gulf War I. It gave us situational awareness where the enemy was flying blind out in the desert, and it was an overwhelming advantage. Well right now law enforcement has nothing like this in terms of technology to give them through situational awareness of their "battlefield".

With EVIDENCE.COM we now take these individual incidents and fuse them together into the big picture. So that of course then feeds back to officers can be redeployed more effectively within the community, of course they've got their TASER so they can do their job more effectively. It feeds back to the legal system with AXON and better evidence. We believe this feedback loop is going to absolutely revolutionize the overall effectiveness of law enforcement.

So TASER historically we have already revolutionized at the tactical individual officer level, now we've got our sites set on revolutionizing law enforcement at the strategic level. And when we succeed at it, we will have created tremendous value and I think it will be transformative for the Company.

So at this point I'm going to go ahead and wrap up. I'll encourage everybody, go to TASER.com or TASERX3.com a little bit later today and you can watch the keynote address from Monday. It's up right now, but to be honest with you, there's something going on. The playback controllers aren't porting out properly. It's an hour and a half long video, and you may not want to sit and watch the whole thing. So come back in a few hours and they'll have the fast forward and the scroll bar. I'll tell you two things you'll want to watch for, go the EVIDENCE.COM section and watch the live demo of the mapping technology. That was the hit of the show, and it was funny, because when I asked the audience how many officers enjoy using their department's computer system, not one hand went up. And when they saw what we're doing with EVIDENCE.COM you'll hear the oohs and ahhs, they're blown away over the tool we're going to give them.

So that's around the middle of the presentation, and then go to the end, there's a section where Tom and I have a pretty good time firing off all these new capabilities, which I think you'll find a little bit entertaining. But I think it will give you an idea how all these devices work. All right, so with that we'll open it up to some questions and then we'll wrap the call.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) We have a question from the line of Eric Wold of Merriman Curhan Ford, please proceed.

Eric Wold - Merriman Curhan Ford - Analyst

Thank you. Good morning guys.

Rick Smith - TASER International - CEO

Good morning.



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Eric Wold - Merriman Curhan Ford - Analyst

I apologize Dan, you rattled off the numbers, if you could just give me the numbers for the X26 units again.

Dan Behrendt - TASER International - CFO

The X26 units were 15,275.

Eric Wold - Merriman Curhan Ford - Analyst

Okay, and then just one more quick numbers question while I've got you. Looking at the tax rate the past couple of quarters, it has popped up, it's nearly 50%. Is that a decent level going forward?

Dan Behrendt - TASER International - CFO

It's going to really depend on, obviously, the second half results, but our effective tax rate ends up being a little bit higher on a year like this when things like the ISO stock options and also things like meals and entertainment and the lobbying end up being add-backs, so our tax level income ends up being higher than book income which drives that rate up from basically a nominal rate like 39.5% it goes up to like 50% when you have some of these add-backs. But that's probably a decent rate as long as we're on track with our total year numbers that we projected.

Eric Wold - Merriman Curhan Ford - Analyst

And then I guess, for anyone, thinking about the upgrade offer that you're doing, thinking back to when you had the N26 and came out with the X26, what was kind of the experience back then of upgrades from departments? As we are now either in a tough economic situation or what not, do you think they're more likely to want to spend money on an upgrade? Or do you think they'll be more likely to spend money on a new product? What is your thinking there?

Rick Smith - TASER International - CEO

Well back in 2003 when we introduced the X26, in its first full quarter of production it blew right past the N26 in sales, so we do tend to see that law enforcement agencies, they tend to buy the best equipment because their lives are on the line. So we had actually, at the time, thought that the price of the X26, we had actually designed it to blunt demand so that we would have time to ramp production and catch demand. That strategy did not work; demand just took off.

The total number of upgrades was less than we had expected. Agencies, once they're on the M26, the main pitch at that point was officer convenience. Hey, this is lighter and it's nicer to carry. And that, I don't think, was as compelling to managers. So, I think, kind of the answer there was, well, suck it up. We already bought you this one. You can wear it in a leg holster or whatever. So, we didn't see that many upgrades. But we saw the new purchases flip over.

I'm hopeful, although -- people just saw it for the first time Monday; they're very excited to see how the agencies respond. I think that we've got a more compelling upgrade argument now, in that the multiple-shot capability is really about officer safety, not just convenience. The improvements in safety, given all of the public discourse on the safety topic, we believe will resonate at the political levels and in the agency better. And then, the additional transparency of the accountability that we can tell you, whether the electricity went into a person or not, exactly how much went out and all the additional data features, we think, will also resonate at the administrative level better. So, my personal feeling is, I think we've got a stronger shot at the upgrade cycle with this transition than we did with the last one.

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Dan Behrendt - *TASER International - CFO*

And this is Dan; I'd add to that, that we, obviously, have a much larger installed base at this point than we did back in 2003. And the units that are out there, there's just a lot more units that are probably closer to the end of their useful life, which we're giving agencies now an opportunity to upgrade, which I think is a better argument, versus, somebody maybe having something that's only a year or two old at that point. Because, really you're just talking about the early adopters in 2003, versus today. It's a much more widely used platform.

Eric Wold - *Merriman Curhan Ford - Analyst*

And then just lastly, any reason why the upgrade offer is only lasting until year-end? Any chance of moving it into next year? Or is that just an issue of kind of not wanting to have that deferred balance lasting longer than it really has to on the income statements; on the balance sheet?

Rick Smith - *TASER International - CEO*

I think we're going to monitor things and we'll end up doing what's right for the business, long-term. But, we believe that the stimulus money that's coming out is going to present a short-term flush opportunity for our customers. And we think that dovetails nicely with the accounting challenges that we face.

So, we believe pulsing it is a shorter program. But it's pretty darned generous. We start at \$800, which is a full trade-in credit. We depreciate the Tasers 3% per month they've been in the field. And then we give them a floor at \$300, no matter how old the X26 is. That's raised some eyebrows. It's compelling enough, particularly for people with older units or agencies that have really 2,000 M26s are going to be able to get a \$150 trade-in credit. And so, it's not set in stone and we wouldn't change it if we felt it was really compelling as we get into this.

But I think we'll be able to wrap it up by the 31st. Danny?

Dan Behrendt - *TASER International - CFO*

Yes. I agree with that and I think we want to drive that adoption cycle quicker and get as many of these out in the field. Because we think that the capabilities of this product are so strong that having those reference customers early, I think, will help us longer-term as well, which is one of the reasons that drove us to have the real generous upgrade, at this point.

Rick Smith - *TASER International - CEO*

And we are giving an X3 to every master instructor that's certified at our instructor school this year. So again, that's a way for us to seed the market because they'll go back and they'll have the latest, greatest equipment. Everybody at the agency is going to want to see it.

And when you see an X26 and an X3 side-by-side, there's really no comparison in my mind which one I'd want to have.

Eric Wold - *Merriman Curhan Ford - Analyst*

And then just one final question and I'll get back in the queue. On the Obama, you know, the stimulus funds coming through, you'll probably know the answer better than I will. I mean, how early was this kind of upgrade potential telegraphed to the police departments, such that they could include it in their request for funds? If it was not included in their request for funds,



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can they amend them? Can it still be kind of used in the kind of flush funds they get given? Or do they have to actually explicitly say what they want to do with the money?

Rick Smith - *TASER International - CEO*

Well, we really struggled with telegraphing this earlier. And we did not telegraph it earlier, frankly, because we didn't want to take the risk of stalling out sales of the X26 until the X3 was ready to go. So, we made the difficult decision of not telegraphing it. And they cannot redirect funds that they've already applied for. Additionally, you know regular [burn grant] funding that's now opening up and I forget when that funding will be released; it's not insignificant either.

But, I guess a way that I would characterize it is, as those stimulus funds come in, they wouldn't necessarily be able to apply to the X3. But when they get those funds that they can apply elsewhere in the budget, it's going to free up other budgetary dollars that they otherwise would've had to spend. So, the fact that the money's coming out, even if it's not specifically earmarked for Tasers, we think will free up other monies to go this direction.

Eric Wold - *Merriman Curhan Ford - Analyst*

Perfect; thank you guys.

Rick Smith - *TASER International - CEO*

Thank you.

Operator

Your next question comes from the line of Paul Coster of JP Morgan. Please proceed.

Paul Coster - *JP Morgan - Analyst*

Thank you. Dan, first of all, I just missed your comments on the deferred revenue associated with the upgrade plan. Can you just talk us through that again, please?

Dan Behrendt - *TASER International - CFO*

Yes. So, the current purchasers of the X26 in the third quarter will be buying it with the right to trade it in. And obviously, previous purchasers didn't know about the X3, so there's no accounting on that. But the current purchasers are buying it with an upgrade right.

So, we value that upgrade right between \$225 and \$275, which means that for sales of the X26 in Q3, we're going to have to defer between \$225 and \$275 per unit. That will flip itself once this program sunsets. But it's going to cause this sort of a short-term deferral of sales, which will obviously impact both sales and profitability; because we'll recognize the full amount of cost of sales but won't recognize the full value of the X26 sales on the quarter.

Paul Coster - *JP Morgan - Analyst*

All right; got it. And then, if it's not exercised, the right to upgrade, then presumably it just comes straight back into revenue at the end of the year?

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Dan Behrendt - *TASER International - CFO*

That's exactly correct.

Paul Coster - *JP Morgan - Analyst*

Okay, got it. You mentioned that the R&D is going to go up. Is it going to go up and then go down or flatten? Or, is it just going to keep going up? I mean, obviously, I'm sure you've got the products, ideas in the pipeline but I'm just trying to get a sense of whether we're going through an abnormal period here or whether this is now normal for the company?

Dan Behrendt - *TASER International - CFO*

My comments are more on that it's going to stay at these elevated levels. I don't expect it to increase significantly from these levels. But I don't want people to sort of model in that all of a sudden the R&D is going to get cut in half in Q3 or n Q4. We're going to probably stay at these elevated levels through the end of the year. And at that point, we'll have to evaluate the products in the pipeline, how quickly we want to bring them to market and adjust the R&D spending accordingly.

Paul Coster - *JP Morgan - Analyst*

What impact do you think the new products have on gross margins, sort of short-term and medium-term through calendar year '10?

Dan Behrendt - *TASER International - CFO*

I think, through the rest of this year, it is probably a little bit of a negative impact as you get through the -- you know, it's certainly a learning curve from a manufacturing perspective but there's also sort of a [valid] engineering process that'll happen. Once the products sort of enter production, we'll look at finding efficiencies.

So, we expect that it will probably have a little bit of a negative impact for this year. Certainly, as we get into 2010, we've got some really good people here and I think some capabilities we did have, a couple of years ago, when were we introduced the C2. So, I expect that drag on gross margin will be shorter than it was, say, last major introduction, which is the C2.

Paul Coster - *JP Morgan - Analyst*

Rick, as you start to launch this set of solutions for law enforcement, do you see this business evolving from a kind of book and ship business into a more sort of programmatic business where you've got more visibility into the sales, into a specific agency?

Rick Smith - *TASER International - CEO*

Absolutely; absolutely, in particular with the software services group, it's more of a recurring revenue model. So, once people become a customer with EVIDENCE.COM, their revenue will be highly predictable.

Paul Coster - *JP Morgan - Analyst*

Right, good. I look forward to that and then, finally, France; what's the latest with respect to the gendarme and their intentions?



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Rick Smith - *TASER International - CEO*

I don't have any specific updates out of France. We have seen some real movement out of Australia, with two of the states making announcements about very significant purchase orders that are pending. So, we've got a lot of work going on there.

We are continuing to work in France. It's just we're not getting a lot of transparency. The French, in particular, have been really pretty secretive about their acquisition process. So, we tend not to get a lot of heads up until we get orders. So, I wouldn't read anything, good or bad, into the fact that we're not getting much feedback. They're just very careful about any appearance of coziness with vendors. So, there's a real wall up to their acquisition process. It just gives us no real visibility.

Paul Coster - *JP Morgan - Analyst*

Thank you.

Rick Smith - *TASER International - CEO*

Thank you.

Operator

Your next question comes from the line of Pete Mahon of Dougherty. Please proceed.

Greg McKinley - *Dougherty & Co - Analyst*

Good morning; it's actually Greg McKinley. Guys, I wanted to ask you a little bit about the X3; maybe you're talking about this at this point, maybe you're not. But when we think about relative ASPs for that product and margin expectations, compared to your current X26 product, how should we think about that difference?

Dan Behrendt - *TASER International - CFO*

Certainly, the ASP; we did announce on Monday that the end user price is \$1,799. As an agency price, it'll be \$1,599. So, certainly a higher price point. One of the things that allows us is it gives us a little bit more room to have these generous trade-in programs, which will help drive the demand.

As a result, we expect that the longest-term margin of the X3 will be certainly right up with our other hand held devices, which tend to be some of our stronger margin products.

Greg McKinley - *Dougherty & Co - Analyst*

Yes, okay. So, comparable to X26 or maybe even better than X26 margins?

Dan Behrendt - *TASER International - CFO*

That's right. I think it'll certainly be comparable to the x26, for sure.

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Greg McKinley - *Dougherty & Co - Analyst*

Okay. And then, in terms of the intended distribution channel for the AXON product, can you talk a little bit about -- it's obviously the same customer base. So there's a lot of leverage for you there, I would think, compared to the products you've been selling in with electronic control devices. But it's a very different product in terms of it's being a software and sort of a service application. Do you need different distributors or different sales capabilities to sell this product, versus how you've sold the handle in the past?

Rick Smith - *TASER International - CEO*

Yes, let me take that one on. The answer is yes and no. So, in its simplest form, we can think of it almost like the iPod, iTunes model, where retailers carry the iPod, which then is [rolled]. You know, obviously, people get on their local back and then they see, wow, I can go and I can buy music right on line through iTunes. Although, in our case, EVIDENCE.COM is a requirement in order to use the AXON. Our distributors, especially because we're really creating this pitch about the value of the full system, this advanced technology officer, that the X3 integrates with AXON and EVIDENCE.COM that all of our current suppliers have got to be able to sell all of it. Otherwise, they're going to get frustrated as will the customer. The customer says, hey, I saw this great brochure. I want to come in and buy this stuff. Well, I can only sell you the handle. So, our distributors are really excited about the opportunity.

Some of them will just be hardware distributors. You know, the ones that are more [firearm] oriented will sell the hardware but they won't be very involved in the software. Then, other of our distributors have expressed an interest in becoming more of a value added reseller kind of partnership, where, because of EVIDENCE.COM, we've built a robust set of APIs so agencies can start to integrate it into the record; management system, their computer aided dispatch system.

So there will be value added integration services that will either require that we bring in additional partners to do that work. Although some of our Taser partners -- I mean, for example, DGG Taser, out of Florida, has built their business centered around TASER. And we have found historically our most successful distributors are the ones that are the evangelists, that live and breathe the TASER mission.

Folks like that have already said they will go out and they will hire additional resources with our guidance and counsel to build out the IT implementation part of their business. And we actually think that that's the right model for us. So the customer has one contact point for those distributors who're willing to make that investment.

Now, we internally have recently hired a dedicated vice president of SAS sales, for software as a service, that will complement our existing hardware sales team. So, she's now starting to build out with sales application engineers that will work with our hardware group. But it's really a team selling approach in that our belief is that the way we win this is we've got to make EVIDENCE.COM appealing to the tactical officers and to the cop on the street; that IT is a very important player.

But IT in law enforcement gets driven by the mission, by the chief and by the tacticians who say, here's what we're trying to do. And then they may go to IT and say hey, find us a solution to make this happen.

If we're successful, which we believe we will be, in driving the training officers and the chief on the strategic level to say, look, we want this capability and it integrates with this hardware that we want that IT, again, will be part of the purchase process but not the primary decision maker.

And where we think we can really outperform, we've been doing a lot of market research with the officers we have here this week, and what we've discovered is that there's a real disconnect between the IT side of the house and the tactics and training side of the house in law enforcement. Namely a lot of cops we talked to are very frustrated that their agencies buy these big behemoth records management systems or computer aided dispatch systems and the training is just, frankly, not there. Yesterday I was at a group of several hundred officers, we were asking questions, and we asked them what they thought about training

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on their agency's computer systems. And the room broke out laughing. When the surveys came back, there was no training. Well that is our forte, if there's things we do well, right at the top of the list is our whole training regime and program, and the 300 master instructors and our in-house training staff, and our ability to create good training materials and deliver it.

So we will be integrating and training on EVIDENCE.COM with the same intensity we train on our weapons systems, which we believe is going to lead to better customer experiences, because the officers will see the value in this, they're going to come out of there really able to use of software every bit as well as they can use our hardware, which will create strong reference accounts and again I think that you might see how that should lead to a very successful sales cycle. So that's how we're thinking about it. It's really adding a new software group with dedicated sales engineers, coupling them with our current Harbor XL teams and our training division.

Greg McKinley - *Dougherty & Co - Analyst*

Okay and then I wonder if I could ask just one follow up question, Dan, on sort of your margin outlook. I think margins are probably a little better than certainly what I expected in the June quarter here. And there's a lot of moving parts as we head into the second half of the year, not only with some of the improvements you guys have been making on your production side, but then we've got new products coming in, we've got some trade in allowances being offered on the X26 sales in the second half of the year. I know you indicated you expect some degree of moderation there in margins as the second half unfolds, but do you care to give us a more specific view on that? Or is that all you guys really want to comment on it at this point?

Dan Behrendt - *TASER International - CFO*

I think you've pointed out it's a little bit soft because obviously sales mix, we saw the impact of sales mix from Q1 to Q2 and what that can do to us. There's a 3.5 point change in margin driven partially, a lot of which was driven by that sales mix. But the way I'd model is, obviously we're still going to target margins longer term to be north of 60. Obviously what I would do is maybe model it in that range and then back out this trade allowance to show where we'll really end up for Q3, and then have that reversing itself in Q4. So we certainly expect the margins in Q3 will be negatively impacted by this trade allowance, so it has modeled that in.

Greg McKinley - *Dougherty & Co - Analyst*

Thank you.

Dan Behrendt - *TASER International - CFO*

Sure thing.

Operator

You have a question from the line of Steve Dyer of Craig-Hallum, please proceed.

Steve Dyer - *Craig-Hallum - Analyst*

Thanks guys, nice quarter. Most of my questions have been answered. First of all, very nice event that you guys put on this week, it was very informative and I think showcased a lot of things very well. A couple of questions I guess just around the cadence of the stimulus spending. You've talked about it a little before, how do you see that sort of playing out from a timing perspective? And again is it kind of a short burst here, kind of late Q3, Q4, or does it have some legs in your mind?

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Rick Smith - *TASER International - CEO*

You know I wish I could give you a good answer. Unfortunately what we've seen is that the administration has been really focused on keeping corporate America out, frankly, of the process. You've seen some edicts come down about lobbyists being restricted very heavily from what they can do to interface with government agencies that are getting stimulus money. And we're seeing that agencies are also being very careful, they're not giving us a lot of feedback. I think everybody's being very careful here, they don't want to be seen as allowing corporations to influence the process, and as such it's just really hard to get good information. Then also I think the government agencies are just struggling to figure out how they're going to get this money out as fast as they're supposed to. So it makes it very hard for us to model or predict. We're finding out about stimulus funds being spent either because a purchase order shows up, or we're reading about it in our media alerts that local newspapers are doing stories about it.

But agencies are not being very communicative on it, nor are the federal folks that we deal with, with our lobbyists in D.C. It's really a black box, I wish I had a better answer, but I don't.

Steve Dyer - *Craig-Hallum - Analyst*

Okay. And just if you could spend a little time on the Shockwave and the XREP, kind of the lesser of two talked about newer products. How do you see that sort of progressing in terms of revenue, maybe anecdotally.

Rick Smith - *TASER International - CEO*

Okay the way to think about Shockwave is, it's really sort of a proof of concept product. For 10 years the military, there's been Power Points circulating around and many a discussion about less lethal area denial systems. And two years ago we made the decision, you know what, we've got to get this off of concept and put a tool out there that they can start war gaming with and make it real. So the primary focus of Shockwave is the military customer, and they've got a long horizon and it's just starting to enter their thinking now. We'll be probably giving a fair number of units away to various training centers and demo centers so that they can get their arms around the concept.

We have had some interest from SWAT teams, we had one in particular that's already used it in a barricade where they've got an armed subject in a house, they gas the house, he comes running out and they had the Shockwave set up so they could drop him from a safe distance. So I wouldn't expect a whole lot of revenue on Shockwave in the next year. That again is more of a future proof of concept.

XREP, we're getting a lot of interest. But extended range is a much lower volume business, at least in the law enforcement market space. The vast majority of competitions happen up close and personal. So, at agencies that might have hundreds and hundreds of Taser uses every year, they might have five or 10 bean bag or extended range uses every year. And it's really that we're competing with now in the extended range market.

So, I think we'll start to see XREP sales; I don't want to give any guidance because, again, our core business is hard enough to guide on. But I think it's fair to measure how XREP is doing because that was developed. That should be a good revenue generator.

You know, long-term, frankly, we think the wireless systems will sell better in the consumer space, in private citizen self defense. We have not launched the XREP in that market and we don't have plans to this year. Next year, we may look at that. And the reason I say that is law enforcement is really focused on -- most of the time, they're not actually defending themselves. They are proactively going out and arresting somebody.



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So, they're very focused on low risk of injury and the hand held devices just do a great job of that. And they're generally close anyway.

These wireless systems, they're going to leave more of a mark. It's a bigger projectile to reach out to extended ranges. It's moving faster; it's going to, potentially, cause a much bigger bruise, contusions. It's going to be a pretty bad thing. So, law enforcement is going to use those more sparingly, in only the very high risk situations but, in that window between relatively high risk but not yet justifying lethal force.

Now when we look at the military customer or the consumer customer, in those applications, if somebody's breaking into your house, you're not too concerned that they might lose an eye, not to be cavalier about it, if you hit them there. You're willing to put up with a little higher risk of injury. And the same with the military customer.

The military, generally, they don't get sued; there are not civil liability issues. They want to keep threats further and further away. Of course, the military takes longer to gestate and adopt new technologies. And in the consumer space, we don't want to launch a wireless technology in the consumer space until we've really got it ironed out with good feedback in the professional space. So, we've elected not to launch in that market just yet.

So, I think you'll see a niche, a reasonably good sized niche market for the XREP in law enforcement and then, over the next couple of years, the other markets will start to adopt and that could really start to take off.

But the big revenue drivers, I would say, my personal expectations, are the X3. It's a big revenue driver. AXON, EVIDENCE.COM are big revenue drivers. XREP is moderate to, maybe, niche; and Shockwave is proof of concept.

Steve Dyer - *Craig-Hallum* - Analyst

Okay, great. Thanks; very helpful. Just a question on the C2; how do you think about that one, I guess, as long as you're kind of going over product lines? I mean, is that an area for investment? Or is that kind of a -- you think that's kind of performing about where you would expect, or hope it to perform?

Rick Smith - *TASER International* - CEO

The C2 is -- it didn't, frankly, hit my expectations where I would like to have seen it by now. And part of the reason there is, we've struggled in the larger retailers. It's something that requires personal interaction. You know, when you go to a major retail store, for the most part, people are in and out on a regular basis, i.e., they're a short job tenure. It's hard to get consistency.

So, we've been struggling a bit to get the right recipe to get the big box retailers more successful selling it. The smaller mom-and-pops are doing pretty well with it. And then, we actually just brought in a new person -- Dan, should we maybe talk about his background?

Dan Behrendt - *TASER International* - CFO

Yes. I think that's fair, yes.

Rick Smith - *TASER International* - CEO

Okay, we haven't put a press release out, per se, but we brought in a guy named Ralph Engleberg who was the former head of sales for Clarion Car Audio. A very sharp guy; really knows the consumer space; has dealt with both big box retailers and the

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smaller independents, like the -- in their business, it was the in-car stereo and alarm installers. He's got some great ideas for how we can be more effective in training.

And then, another thing we're starting to look at is how can we more effectively use the TASER brand? We have a significant brand awareness out there; you know, over 90%. We've got an extremely strong brand. So, as we look to the future, we're starting to think not only in terms of what are the proprietary products we can develop, but are there complementary products that might fit under our brand, that could build a stronger overall retail presence.

And I'm getting a little ahead of myself because that strategy is not yet fully fleshed out. But, I think we've got somebody now that can kind of own that business for us. And it's a nice part of the business if we decide to tap today.

Dan Behrendt - *TASER International - CFO*

5% of sales.

Rick Smith - *TASER International - CEO*

5% of sales but, I see an opportunity to grow that. We've not yet found the model where we can invest a dollar and get \$5.00 back. It seems to be more organic in its growth. The high touch, lots of interaction and we haven't got a replicable model yet on how to scale that to the level where we'd be happy. But we are working on it.

Steve Dyer - *Craig-Hallum - Analyst*

Okay thanks and then just last question, Dan, do you have a CapEx number for the quarter?

Dan Behrendt - *TASER International - CFO*

Yes. CapEx for the current quarter? Yes, year-to-date, we're obviously about \$4.8 million. Let me just pull up the quarter here.

Actually, I just have the year-to-date number so I'll give you a call after this with the breakout of the current quarter. But it was pretty significant in the quarter, especially with the addition of the equipment in our first datacenter for EVIDENCE.COM.

Steve Dyer - *Craig-Hallum - Analyst*

Okay. Just give me a call; thanks.

Operator

There are no further questions at this time. I would like to turn the call back over to Mr. Rick Smith. Please proceed.

Rick Smith - *TASER International - CEO*

Thank you. Well again, I really encourage you, if you're interested in learning more about where we're going and how this all fits together, go to taser.com later today and watch the keynotes, particularly the parts on EVIDENCE.COM and then the conclusions sections.



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If you want to go a little bit later today, we're just having some trouble with the player controls because it's such a large video. It's an hour-and-a-half long. And they just got it uploaded last night, so they're still tweaking it. So, go back in a couple of hours to taser.com; check it out. Thank you for your time. We've had you for over an hour this morning.

I don't know about you; I am beyond excited about where we're going. If the X3, in particular and EVIDENCE.COM and AXON hit, it's going to be an exciting time for us.

So, we appreciate your patience with us as we've made the heavy investments required to make these things happen. And over these next two quarters now, it's time for these investments to start delivering.

So, thank you very much.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.

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