

A WINDOW IN

SPRUCE POINT CAPITAL MANAGEMENT AND ANSON FUNDS HAVE BOTH PLACED BETS AGAINST STUN GUN DEVELOPER AXON ENTERPRISE, CLAIMING THE BUSINESS WILL FACE A SLOWDOWN IN GROWTH. ELANA DURÉ EXPLAINS WHY THE PAIR THINK AXON IS "A STUNNING SHORT."

AXON ENTERPRISE

SECTOR: INDUSTRIAL GOODS	MARKET CAP: \$4.0B (MID CAP)	EXCHANGE: NASDAQ	TICKER: AAXN	HQ: SCOTTSDALE, AZ
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In the month since Spruce Point Capital Management revealed its short position in Axon Enterprise, the stun gun developer has seen its share price drop nearly 6% – not quite as much as the short seller's 40%-60% downside prediction, but enough to infer that its short thesis piqued the interests of some investors.

Axon, formerly known as Taser International, is an Arizona-based company that develops tasers and body camera technology for law enforcement. After following the company for “a long time,” Ben Axler’s firm released its report on June 19, noting that its research included conversations with a law enforcement expert, former Axon product executive, and leading global competitor.

Spruce Point predicted that Axon’s two units, taser and software and sensors, would experience a slowdown in growth and margins. “With a history of SEC inquires, delinquent filings, and material weaknesses, we believe Axon will shock investors with significant earnings disappointment and increasing cash burn as it fails to scale beyond these niche businesses,” it said.

In response, Axon told *Activist Insight Monthly* that Spruce Point had “put out a poorly researched report that is riddled with inaccuracies and innuendos.” Specifically, the firm argued that its accounting practices and Securities and Exchange Commission disclosures “are sound,” adding that it “feels great” about its market positioning.

THROUGH THE LOOKING GLASS

Spruce Point was not the first short seller to take note of Axon. **Anson Funds** in December 2018 presented a bearish thesis on the firm at Kase Learning’s Shorting Conference, claiming Axon “is using profits from the taser business to

fund a potentially broken body camera business that likely won’t be as profitable as expected.”

Axon first caught Anson’s attention after the police shooting of Michael Brown on August 9, 2014. The tragedy in Ferguson, Missouri shook the U.S. and prompted a surge in popularity of Axon’s body camera technology, providing Anson with an opportunity to examine the company, which has since seen its share price rocket 421%.

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Anson concluded that the hype behind Axon’s body camera business is not warranted because the unit utilizes unproven technology and has fierce competition. Moreover, the short seller said the unit is a low-margin business because Axon charges clients three- to five-times more than competitors for its cloud software. “The body camera business doesn’t appear to be all they claim it to be,” portfolio manager Sunny Puri told *Activist Insight Monthly*. “All that glitters is not gold.”

Spruce Point’s greatest apprehension also related to the body camera business, which the firm is using to try to

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position itself as a software as a service (SaaS) provider to law enforcement agencies.

"Our biggest long-term concern is how will Axon deliver on its ambitious goals and grow into the ever-expanding total addressable market (TAM) it is promoting as it tries to position itself more as a software company," Ben Axler told *Activist Insight Monthly*. The short seller said Axon's reported TAM is largely unproven and is being exaggerated with unrealistic pricing assumptions.

In addition, its software and sensors unit (including Axon Cloud) is experiencing a slowdown, while the segment's margins are contracting. "We believe these trends will continue as costs escalate from offering unlimited video storage, and competition increases," Spruce Point said in its report. Axler told *Activist Insight Monthly* that he would be "impressed" if Axon won a major records or dispatch management software deal with a top-10 city.

Axon, however, said in a presentation at the Baird 2019 Global Consumer, Technology & Services Conference that it is driving TAM through "value-added features" as it expands into international markets and captures adjacent markets like military and federal, fire and EMS, and commercial enterprise.

STUNNINGLY STAGNANT

As for the taser business, Anson learned that Axon has been pulling forward sales using aggressive accounting. Specifically, the firm reports disproportionate revenue upfront instead of over the life of its five-year contracts with police departments. "Because of the aggressive sales methods, including financing plans,... growth of Axon's taser business is likely to be incrementally difficult going forward and the inflection point may already be behind us." In addition, Anson predicted that Axon will face fierce competition later this year when peer PhaZZer releases tasers, thereby challenging Axon's margins and potentially threatening its top line in its taser business.

Spruce Point echoed Anson's sentiment, stating that Axon's core stun gun product is mature with limited domestic unit growth opportunities. The short seller said Axon's newest model will only provide a short-term benefit. "Now five years into the taser 60 program introduced in 2014, and with the Taser having a five-year expected life, we believe its early mover advantage is being eroded by

competitors pricing and solutions on the software and sensor side," Spruce Point wrote in its report. "Axon's best gains are now behind it"

JUSTICE WILL PREVAIL

Other red flags listed by Spruce Point include an increase in operating cash burn, a sell-off of insider stock, and a failure to disclose accounting errors tied to compensation expenses. Moreover, the short seller noted Axon's reliance on imports from China, predicting that costs associated with ongoing tariffs will weigh on margins. Anson, meanwhile, pointed to Axon's history of giving perks to police department officials.

Axon, however, denied the accusations and noted the short sellers' motives of trying to decrease the firm's stock price. "While short sellers seek to spread fear, uncertainty, and doubt in hopes of knocking our stock down to make a short-term profit, Axon is focused on long-term solutions such as making the bullet obsolete, improving police-community relations, and enabling a fairer justice system," a spokesperson told *Activist Insight Monthly*.

The firm said it is actively mitigating its China exposure, adding that it is not concealing the fact that it has suppliers in China. Moreover, the firm said it "feels great" about its ability to disrupt the police Records Management Systems and Computer Aided Dispatch markets. "We feel great about our market positioning and intend to execute," the spokesperson said. 

AXON ENTERPRISES' SHARE PRICE PERFORMANCE

