

Red Cat Holdings, Inc. (RCAT) ***Flying Blind***

We are short shares of Red Cat Holdings, a \$1 billion drone manufacturer that's added more than \$900 million in market capitalization over the last 9 months mostly in anticipation of an award for the production of the US Army's short range reconnaissance (SRR) drone and the supposedly massive market opportunity unlocked by such a high-profile endorsement. But expectations for both the SRR contract size and the potential for follow-on sales bear almost no relationship to reality.

Army budget documents clearly delineate an SRR budget for 2025 of just under \$25 million, and an expectation of about the same in the medium term. The Army also intends to refresh the SRR model every 2-3 years while remaining open to switching contractors. That contrasts sharply with Red Cat management's crafty portrayal of a sole-source contract worth close to \$400 million over 5 years, and \$80 million in 2025. Investors should also consider that Red Cat preemptively announced the program win without the Army's permission, weakening its position in contract negotiations and even, in a worst-case scenario, endangering the award.

Red Cat's depiction of a huge follow-on market consisting of the other US military services, US government agencies, and US-allied militaries is also a fantasy. The Air Force has little infantry and thus little use for an infantry drone, and the Marines and Coast Guard have preexisting drone programs. The only other relevant government agency is Customs and Border Patrol, and its budget documents indicate near term drone procurement of just \$1 *million*. Meanwhile, management has been talking about massive imminent drone sales to NATO allies for the last 3 years with nothing to show for it, which could be because European militaries are more inclined to modify cheaper and better Chinese drones or because there's an array of smaller home-grown European drone suppliers already supplying these customers.

Just like those elusive NATO contracts, Red Cat has been setting near-term deadlines for a "mass production" facility since 2022, but having devoted almost no capex to one, still can't manufacture large quantities of drones. 2025 guidance, though, assumes that Red Cat will produce 3 new drone models, each at *triple* the speed of the company's historical best seller. One of those new drones, the Edge 130, comes to Red Cat through a 2024 acquisition and has never been produced as more than a prototype.

Red Cat's declarations and projections rarely materialize, and we believe the same will be true of both the company's 2025 guidance and the parameters of the SRR contract. Almost immediately following the SRR win, two key executives – including George Matus, the brains behind the SRR-winning drone – resigned and sold most of their stock. Share sales have also been made by other insiders. Having set almost impossible expectations, Red Cat is set to be blown out of the sky.

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I. Investment Highlights

The SRR contract that Red Cat won in November and preemptively announced without the Army's permission is much smaller and less favorable than management has intimated. Red Cat management has spent years hyping the potential of Tranche 2 of the Army's Short Range Reconnaissance (SRR) small unmanned aerial system (sUAS) program for which the company was competing. Investors were initially led to believe that the revenue potential of a win would be in the billion dollar range over the course of 5-10 years. Upon winning the contract, management curbed those expectations by quite a bit, though *still* signaled revenue of \$260 million for 5,880 drone systems over the next five years, plus about 30% of that sticker price to be earned in repairs, replacements, and training services. Management called out \$80 million in 2025 expected revenue, specifically citing the National Defense Authorization Act (NDAA) text.

But the NDAA says nothing about the SRR funding in particular and the Army's detailed funding request for 2025 shows that the service expects to procure between 275 and 300 systems annually at a cost of \$20-25 million, which is a very far cry from Red Cat's 2025 SRR guidance. Additionally, the cost for repairs, replacements, and related services are *included* in that \$20-25 million, so Red Cat's "plus 30%" should be entirely discounted.

The claim that the contract will be a five-year fixed-quantity sole-sourced agreement is also contradicted by the Army's public disclosures and announcements about the program. The Army has repeatedly emphasized that in order for its small-drone procurement to be flexible and adaptive, it plans to conduct a product refresh every 2-3 years while leaving the door open to new suppliers with potentially superior technology. Several defense procurement specialists with whom we spoke confirmed that the SRR program was indeed designed accordingly. While the contract Red Cat signs might stipulate a 5 year term and specific quantities, those are *upper bounds*, not hard-coded expected values.

We also discovered in the course of our diligence that Red Cat's November announcement of the SRR contract win was made improperly without the Army's approval. While that's unlikely to scuttle the contract win completely, our sources indicated that it might make negotiating the precise contract terms with the Army contentious and more difficult for Red Cat. It may also result in the Army more strictly enforcing contract terms and more willing to contemplate other suppliers if and when the opportunity presents itself.

Red Cat has been misleading investors about its manufacturing capacity for years. Over the last 3 years, Red Cat has promised investors *multiple times* that within some clearly definable near-term deadline it will be capable of producing "thousands of drones" per month. First it was "by the fall" in early 2022, then it was "in a few months" in November of 2022, then "now" in March of 2023, then "in a few months" in July of that year, then "now" (again) in early 2024, and most recently (in September) it was to be at some point in 2025. We present the full comical timeline of management's contradictory and misleading assurances below, but investors shouldn't find it funny that drone industry sources close to the company don't think

Red Cat has the manufacturing capability for mass production of drones. Getting there would take time and a real capital expenditure commitment. Considering that Red Cat has dedicated a total of just \$3 million to capex over the last 3 years (most of it in 2022), it's going to be a long and expensive slog to the kind of facilities that would enable a respectable drone manufacturing operation. It certainly won't be ready to meet investor expectations for 2025.

Management has also sent conflicting signals about Red Cat's ability to manufacture more than one model on the Teal production line. On the one hand, management is guiding to tens of millions of dollars in 2025 revenue from *each* of the Teal 3 and Black Widow (SRR) models. On the other hand, management blamed the precipitous dip in sales of the Teal 2 model in the second half of 2024 on the need to retool the factory for the SRR. So, can the factory produce two models simultaneously? Realistically, we think Red Cat faces a dual predicament – the company indeed lacks the manufacturing capacity to produce two models concurrently and, at the same time, demand for its \$15,000 drones is much weaker than management lets on.

Contrary to Red Cat's grandiose claims, the opportunity to sell Red Cat drones outside of the US Army is negligible. Listening to Red Cat's management, you'd be forgiven for thinking that hundreds of millions of dollars of drone acquisition decisions were hinging on the results of the SRR competition. Now that it's been decided, the Marines and the Air Force and the Departments of Interior and Homeland Security and an array of NATO militaries will be lining up to bid on Red Cat's Black Widow or Teal 3 drones. The dam on the sales channel, so goes the narrative, has burst.

But it's nonsense.

First, there isn't much use for *infantry* reconnaissance drones in the Air Force, which doesn't really have much...infantry. As for the Marines, their small-drone program is even more modest than the Army's (by 60%) and already spoken for with other suppliers (Lockheed and FLIR, among others). So the Black Widow sales channel at other US military services is nonexistent.

Meanwhile, the Department of Interior is committed to buying drones as cheaply as possible and hasn't acquired more than a handful of them in the last few years, ever since the government-wide prohibition on Chinese drones went into effect. Eventually, when they do get past the holdup, their public records indicate that they'll opt for a drone made by Parrot that's similar to Teal's but wholesales for less than half the price.

Over at the Department of Homeland Security (DHS), of the "16 organizations" Red Cat is excited to sell to, only two of them – the Coast Guard and Customs and Border Patrol (CBP) – have anything approaching a drone procurement program. The Coast Guard's near-term budget is less than \$1 million annually and dedicated to servicing the drone fleet they already have. CBP is interesting because Red Cat has been talking about selling to CBP for years. The company even announced in 2022 that it won a \$90 million contract to supply CBP with drones. That contract turned out to be a multi-year multi-supplier contract through which Red Cat sold a grand total of \$1.8 million in drones. As for the near term, CBP's published budget indicates that

they're in the market for 60 drones, which would amount to less than \$1 million in revenue for Red Cat. Not exactly a sales gusher (even if Red Cat wins the entire bid).

Finally, NATO allies. This is another market that Red Cat has perennially been on the verge of cracking. On no fewer than *six* different conference calls since early 2002 has Red Cat promised that a drone contract with a NATO ally is right around the corner: "within a month" (in March, 2022), "next year" (in November, 2022), "we *received* initial orders" (March, 2023), "set to be announced in Spring" (last March), "in the next 2 months" (last August). Often, these pronouncements have come with the tantalizing promise that the NATO contracts are "several times the size" of the SRR program. So far, though, *nothing* in the way of wins or sales. So skepticism of the more recent promises is warranted. Moreover, Europe's military drone market dynamics are very different than America's. For one thing, the market is a lot more fragmented on both the buyer and seller sides, so the average contract is less than half the size of similarly specced contracts in the US. For another, European governments don't seem as fazed by the prospect of Chinese drones. In Germany, for example, the military simply approved the acquisition of Chinese drones – generally both cheaper and more capable than American made drones in the category of the Black Widow – as long as they're properly modified by approved German suppliers. Red Cat military sales to US allies? Don't hold your breath.

Red Cat's 2025 guidance excluding the SRR is laughable, and we don't think the company will come close to meeting it. Red Cat is guiding to \$50-55 million of revenue in 2025 *excluding* any revenue from the SRR. Of that revenue:

- \$20-25 million comes the Teal 3, the successor to the Teal 2.
- \$20-25 million comes from the FlightWave Edge 130
- \$5-8 million comes from the FANG FPV

As we said above, the guidance for the Teal 3 is hard to square with management's explicitly stated inability to effectively manufacture two products in the single existing Teal facility. In mid-December, CEO Jeffrey Thompson, supposedly frustrated with the production line pause of the Teal 2, was "so excited that we don't have to switch aircraft for the first time ever and just build" the SRR in 2025. But if Red Cat is going to generate \$20-25 million in Teal 3 sales, it's definitely going to need to switch aircraft. So either margins will be disastrous or the guidance for the Teal 3 won't be met.

The Edge 130 (the other half of the guidance) is a light VTOL drone, somewhat larger than the Teal 2 and SRR, manufactured by FlightWave, a small California drone company that Red Cat acquired in September. In mid-December, Red Cat's management made passing mention of the fact that FlightWave didn't even *have* a manufacturing facility for its drone, but that management expected a makeshift facility to be ready by mid-January and a full-fledged manufacturing operation to be up by mid-February. We're skeptical. It's been about 3 years and *Teal* doesn't even have a production facility that can scale. How will Red Cat build a brand new manufacturing operation – in a different state than the Teal factory – and churn out \$25 million worth of the Edge 130 in its first year of operations? And without losing money?

Here's a different way to think about the whole of Red Cat's 2025 guidance: Red Cat's most successful product ever – the Teal 2 – sold about 1100 units and \$17 million over 18 months of production. Red Cat's 2025 guidance assumes that 3 never-before-manufactured drones – the Black Widow SRR, the Teal 3, and the Edge 130 – will *each* be successfully manufactured and sell \$20-25 million in a single year. After 3 years in which almost every single assurance or prediction from management turned out to have been misleading, mistaken, or dishonest, the likelihood of that happening is close to nil.

Teal's wunderkind founder and brains behind the SRR, George Matus, resigned just a week after the SRR announcement, with CFO Leah Lunger resigning just 3 weeks later.

Red Cat is the result of several small drone-company acquisitions, only one of which – Teal – remains a part of the company (FlightWave was just acquired so the jury is still out). Teal was founded by Matus in 2015 when he was still in high school, raised \$16 million in venture capital along the way, and was then acquired by Red Cat for \$10 million in 2021. The acquisition occurred after Teal's first significant product – the Golden Eagle – had lost the competition for Tranche 1 of the SRR but still made it onto the Pentagon's Blue UAS list of drones that were preapproved for military purchasing. The initial terms of the acquisition included rich incentives that would leave Matus with potentially tens of millions of dollars of Red Cat stock if subsequent sales of the Golden Eagle materialized. None of those incentives were activated because sales of the Golden Eagle were negligible. It seems like Matus thought Red Cat would help Teal with manufacturing and sales (otherwise why sign such an optimistic incentive package as part of the agreement?) and was sorely disappointed. He continued to lead Teal, though, through the adaptation of the Golden Eagle into the Teal 2, and then the adaptation of the latter into the military grade Black Widow that ended up winning Tranche 2 of the SRR competition.

According to Red Cat's 2024 proxy, in May of last year, Matus negotiated a 900,000 share grant, a third of which would vest upon an award from a particular customer (we interpret this to be an SRR win), and the rest of which would vest at different points in time. Six days after Red Cat announced the SRR award, Matus gave 30 days' notice of his resignation. Between December 20th and December 27th, he sold about 800,000 shares at an average price of \$11.75. Just a few days after his resignation, Matus announced he was co-founding a new company dedicated to addressing weaknesses in the defense procurement ecosystem, which suggests that his resignation was a long time in coming. That seems to us like a harsh repudiation of Red Cat and its management team, and a vote of no-confidence in the ability of the company to achieve what management says it will.

Matus wasn't the only one at Red Cat lacking conviction. CFO Leah Lunger announced on the mid-December earnings call that she was resigning for family reasons and sold half a million shares – about 60% of her holdings – for \$9.52 on December 20th. Other directors and insiders – including CEO Jeffrey Thompson! – have sold a total of 1.6 million shares for over \$16 million just since December 20th. Given the slim chances for Red Cat's 2025 plans to come to fruition, shareholders may follow suit.

II. The Drone Dream

Red Cat Holdings Inc: Capitalization and Financial Results					
Capitalization		Financial Results			
Share price (\$)	\$ 10.91		FY '23	FY '24	TTM
Fully diluted shares (mm):		Revenue	4.6	17.8	16.5
Shares outstanding	78.0	Operating Income	\$ (25)	\$ (18)	\$ (24)
Dilutive impact of Warrants	1.4				
Dilutive impact of Options	6.8				
Dilutive impact of Convertible	2.3				
Dilutive impact of FlightWave					
shares	0.5				
Restricted Stock	1.8				
Total	90.7				
Fully diluted market cap (mm)	\$ 990				
Less: net cash	10				
Enterprise value	\$ 980				

Source: company filings, Kerrisdale analysis

Puerto Rico-based Red Cat Holdings came public in mid-2019 through a reverse-merger acquisition of publicly traded failed bitcoin miner TimeFireVR. At the time, Red Cat was a revenue-less shell company with [plans](#) to sell “simple and secure blockchain-based black box storage, analytics, and services” to drone manufacturers. That business never seems to have gotten off the ground and over the next two years Red Cat embarked on a \$14 million series of stock-based acquisitions of first-person-view (FPV) drone companies. The bulk of these acquisitions have since been sold to Unusual Machines (UMAC) for a 49% stake in post-IPO UMAC, and that has since been disposed of for \$4.4 million.¹

In July 2021, Red Cat announced the acquisition of Teal Drones in an all-stock transaction that ended up being valued at about \$10 million. While Teal was not generating any meaningful revenue at the time, the company had been founded in 2015 by Thiel Fellow George Matus and had developed a quadcopter drone – the Golden Eagle – that was one of 5 approved drones on the Blue UAS list kept by the Department of Defense’s (DOD) vaunted Defense Innovation Unit (DIU). The terms of Red Cat’s acquisition suggested that Matus was very optimistic about the prospects of the Golden Eagle: he negotiated to receive an incremental \$4-16 million in Red Cat shares if sales of the Golden Eagle would clear a series of revenue hurdles in the \$18-36 million range in the 24 months post-transaction-close. Matus’s subsequent journey from the dream of a sales bonanza to the disappointment of almost nothing is exactly the path we expect current

¹ It’s ironic that UMAC itself has recently been the object of a retail-shareholder frenzy, and at the current stock price, Red Cat’s holding in UMAC would have been worth close to \$55 million rather than the \$4.4 million it received last July.

Red Cat shareholders will experience in the next few months. To understand it, we offer a brief history of the US military's history of drone deployment and Red Cat's entrance into the space.

The DOD has been publishing unmanned aerial vehicle (UAV) roadmaps since [at least 1988](#). But DOD is slow and bureaucratic and while there were some high-profile drone systems used in the wars in Iraq and Afghanistan, the urgency to be on the cutting edge of UAV technology didn't really exist until relatively recently, especially in the realm of small drones that could be carried by soldiers in the field (the current label for these is "small unmanned aerial systems," or sUAS). Consider, for example, that [AeroVironment's RQ-11 Raven](#) – a small hand-launched remote-controlled medium-range drone used by all branches of the military – was introduced in 2004, modified in 2013, and is still widely used despite the many advances in drone technology over the last 20 years. The 2013 modification came at the behest of the Army's Rucksack Portable UAS Increment II Capability Production Document (RPUAS CPD), which is the bureaucratic name for the plan the Army then adopted to procure small drones for its squads, platoons, and companies.² While the Army chose to modify the Raven in order to fill the role of company-level drone, it took almost 5 years – until [May of 2018](#) – to *contract* for the first batch of squad-level drones, for which the [FLIR Black Hornet](#) UAS was chosen. The Army is still – more than 6 years later – only about halfway through its goal of getting every squad in the army to operate a Black Hornet.

As for the platoon-level drone, that's where Red Cat enters the story. The solicitation for this system – known as the short-range reconnaissance (SRR) sUAS – was only first [posted](#) by the Defense Innovation Unit (DIU) in September of 2018, five years after the Army's sUAS plan was approved. DIU had been created in 2015 as a DOD sub-agency based in Silicon Valley tasked with bringing the benefits of the technology industry's rapid innovation cycles to the military by partnering with non-defense-oriented tech companies. In line with those goals, the Army [announced](#) in April of 2019 that 6 companies were selected to develop prototypes and compete for the SRR program. Five of them – including Teal – had never worked with DOD previously. The Army aimed to "move with speed" and "transition the best technology to production to be fielded within months, not years."

In late 2019, as the Army's SRR program was moving forward, Congress formalized a prohibition on the procurement of any drones by the military that were either manufactured in China or incorporated critical parts that were manufactured there. In an effort to streamline DOD's acquisition of drones, including those competing for the SRR program, DIU set up "Blue UAS" the following August, a program that would vet small commercial drones' compliance with procurement rules and approve them for purchase across the entire military. The first batch of drones to go on the Blue UAS list was comprised of the five commercial candidates for the SRR program, one of which was Teal's Golden Eagle. Two years after the Army declared its intention to field the SRR "within months," it [announced](#) that Skydio's X2D drone was selected for

² A [squad](#) is typically comprised of about 10 soldiers, a platoon is comprised of 2-3 squads, and a company is comprised of 3-4 platoons. The idea was to procure a small drone for the squad level, a slightly larger one for the platoon level, and modify the Raven for the company level.

integration into the SRR program, and the initial production contract was finalized a year after *that*, in [February of 2022](#).

Teal's acquisition by Red Cat in July of 2021 was negotiated in the wake of Skydio's being chosen for the first tranche of the SRR program. Teal wasn't going to be the supplier on Tranche 1, but the Golden Eagle's inclusion on the Blue UAS list made it an approved product across all branches of the military, and based on the deferred compensation he negotiated at the time of the acquisition, Matus must have assumed (or been persuaded) that Red Cat would enable Teal to manufacture and sell tens of millions of dollars' worth of Golden Eagle drones in the two years following the close of the transaction. But sales came in well below any of the hurdles in Matus's incentive agreement: we estimate that Teal generated about \$4-4.5 million in revenue in the 8 quarters following the acquisition's closing.

Since the Golden Eagle disappointment, Red Cat's fortunes have picked up. The Golden Eagle's successor – the unimaginatively named [Teal 2](#) – was a bit more successful, having generated about \$17 million in sales since it was officially released in April of last year. Red Cat has also found itself the beneficiary of an almost surreal confluence of market trends and hype that have been bubbling for years and have just come to the fore: the wars in Ukraine and the Middle East have made the supposed utility of drone warfare highly salient in the public eye; Elon Musk is [extolling](#) the virtues of drones on X (and potentially among the new administration's staff); and the Pentagon is making headlines by allocating billions of dollars to drone procurement. Most importantly, Red Cat announced at the end of November that its Black Widow drone – a souped-up military grade version of the Teal 2 – won the competition for production of the second tranche of the SRR over Skydio. On the heels of the win, Red Cat's market capitalization has almost quadrupled to just about a billion dollars. We believe there's *no chance* that the reality will even come close to unfolding in a way that justifies the euphoria.

III. The SRR Contract Terms are Much Less Favorable than Red Cat's Management Asserts

The [press release](#) issued by Red Cat on November 19th announcing its win of the SRR contract is suspiciously lacking in detail. The only substantive aspects of the program mentioned in the PR are contained in a sentence in the last paragraph: “The company is focused on ramping production of Teal's next generation system to meet the Army's currently stated acquisition objective for 5,880 systems, which is subject to change over the 5 year period of performance.” That's carefully worded to makes it *seem* like the Army is going to procure 5,880 “systems” from Red Cat over a 5-year period without actually saying exactly that.

In the Town Hall conference call that took place on the same day, Red Cat's management added a lot of detail. The following statements about the number of drones in the contract, the pricing, and the revenue opportunity, are all taken from the transcript of the call, which was filed by Red Cat in a [form 8-K](#) the next day (emphasis is ours):

The average price of a system, which includes two drones and one controller is around \$45,000, depending on configuration. And the Army's stated authorized acquisition objective (AAO) is 5,880 systems...You can do some simple math on those numbers. And we also expect the Army to buy spare parts, training, and maintenance in addition to systems themselves. I think it's also worth noting that the Army's acquisition objective number was created before the invasion of Ukraine and before the world realized that drones are really as impactful as the introduction of the machine gun 100 years ago. In my opinion, the United States Army is going to need a lot more drones.

Right now, in the National Defense Authorization Act, **we're sitting at an approximate program line value. And this is the line that supports SRR of \$79.5 million.** Now, that is a...that number is not final. The NDAA is still not passed and won't be for about 60 days, but we feel very confident that through this support, we'll be able to expand this program going into the future.

The key takeaway from this is what we're talking about today specifically is the SRR **program of record and typically year over year, you could expect somewhere in the range of 30% added for spares, repairs and training year over year.**

We're now in that process for the LRIP [low-rate initial production] contract. To hopefully get that done by end of December, early January. And then we're supposed to be making the first deliveries in late spring, **and we only have till the end of September to deliver on 2025 calendar. So, it could be up to 79 million. Once we have more clarity, we think it's easily going to be in the close to 50 million anyway for 2025 calendar so guidance will probably, and this isn't official guidance yet, but again, we just got this notification we think it'll be approximately 50 million from SRR.**

In response to a question about whether Red Cat/Teal will be the only provider on the SRR contract, Matus (still CTO at the time) replied that "the answer is yes, Teal was the only vendor selected to move into production." To summarize Red Cat's version of their SRR win: Teal will be the sole supplier to the Army of about 12 thousand drones and 6 thousand controllers at a cost of \$45 thousand per system, for a total revenue over a 5-year period (that's based on the press release) of about \$265 million. Tack on 30% for "spares, repairs, and training" and you get to a number closer to \$350 million. As for calendar year 2025, Red Cat guidance is that they expect the SRR to bring in \$50 to \$80 million in revenue.

Before we get to the real numbers underlying the SRR contract (based on documents from the Army and DOD), it's worth looking at a timeline of Red Cat's claims regarding the size of the SRR program:

July 27th, 2022 Earnings Call: "If we get a huge order from the government or if we win tranche 2, which is for **tens of thousands of drones and hundreds of millions of dollars worth of revenue**, we want to have the capital in the bank instead of doing things like buybacks."

July 27th, 2023 Earnings Call: “We still do not know the size of the award for the now combined Tranche 2 and 3. Here is the information we do have. **Tranche 1 production award was \$100 million for approximately 1,000 drones. Tranche 2 and 3 is for approximately 12,000 drones...**”

September 19th, 2023 Earnings Call: “We don't know what the actual contract amount is, but the \$100 million drones [in Tranche 1] was for -- **\$100 million was for 1,083 drones, the remaining amount on this contract is for 12,000 drones...I'm not doing linear math. I'm not saying that this is going to be a \$1.2 billion award, but I am saying, it's going to be significant.**”

March 18th, 2024 Earnings Call: “So the final winner take-all selection is expected by September 2024. The contract is for approximately 12,000 drones. **The award for the first tranche of production drones 2 years ago was \$100 million for 1,083 drones.**”

September 23rd, 2024 Earnings Call: “yes, some of the things that you can find online **for the first year of deliveries between May and September of 2025 is approximately \$79 [million].** That's the same number we found out there.”

November 19th, 2024 Town Hall: “**So, it could be up to 79 million. Once we have more clarity, we think it's easily going to be in the close to 50 million anyway for 2025 calendar** so guidance will probably, and this isn't official guidance yet, but again, we just got this notification we think it'll be approximately 50 million from SRR.”

December 16th, 2024 Earnings Call: “And **we upped our guidance from \$50 million to \$55 million goalposts and we put some kind of wide goal posts out there, \$80 million to \$120 million. So that's basically adding what we think SRR related revenue is going to be** to the total.”

If you're keeping track, Red Cat

- a) Went from consistently claiming – for years – that the total size of the program would be approximately a billion dollars to claiming it would be close to \$350 million.
- b) Went from claiming the first year of revenues would be about \$80 million to claiming it would be \$50-80 million.

Particularly funny (or disingenuous, we're not sure) is how Red Cat arrived at an implied estimate for the total size of the SRR program. Basically, they looked at the Tranche 1 numbers – about 1000 drones sold by Skydio to the Army for \$100 million – and extrapolated to Tranche 2: if a thousand drones is \$100 million, then 12 thousand is, well, even if you're not doing “linear math,” it's in the billion dollar range. The problem is that Skydio never sold the Army 1000 drones for \$100 million. Skydio's production contract with the army stipulated a \$100 million *ceiling* but [Federal Procurement Data System records](#) show that the Army only used [\\$47.8 million](#) of the total contract's capacity and acquired [1083 systems](#) (that's about 2200 drones). If you extrapolate to the 5880 systems in the SRR Tranche 2 contract, you get...\$260 million for Tranche 2, and that's *including* spares and repairs (still a lot less than the current \$350 million

guidance, and less than a quarter of the original billion-dollar-plus insinuation). This kind of confusion, cluelessness, and backtracking is actually not all that uncommon for Red Cat, and we'll explore this at some length below as it relates to Red Cat's manufacturing capacity and customer acquisition claims.

SRR Army Procurement Request Detail										
UNCLASSIFIED										
Exhibit P-40, Budget Line Item Justification: PB 2025 Army								Date: March 2024		
Appropriation / Budget Activity / Budget Sub Activity: 2031A: Aircraft Procurement, Army / BA 01: Aircraft / BSA 10: Fixed Wing						P-1 Line Item Number / Title: 9678A12500 / SMALL UNMANNED AIRCRAFT SYSTEMS				
ID Code (A=Service Ready, B=Not Service Ready):				Program Elements for Code B Items: N/A			Other Related Program Elements: N/A			
Line Item MDAP/MAIS Code: N/A										
Exhibits Schedule					Prior Years	FY 2023	FY 2024	FY 2025 Base	FY 2025 OCO	FY 2025 Total
Exhibit Type	Title*	Subexhibits	ID CD	MDAP/MAIS Code	Quantity / Total Cost (Each) / (\$ M)	Quantity / Total Cost (Each) / (\$ M)	Quantity / Total Cost (Each) / (\$ M)	Quantity / Total Cost (Each) / (\$ M)	Quantity / Total Cost (Each) / (\$ M)	Quantity / Total Cost (Each) / (\$ M)
P-5	A12511 / SHORT RANGE RECONNAISSANCE	P-5a, P-21			- / -	207 / 6.725 ⁽⁷⁾	459 / 20.769	270 / 69.573	- / -	270 / 69.573
P-40	Total Gross/Weapon System Cost				- / -	207 / 6.725 ⁽¹⁾	459 / 20.769	270 / 69.573	- / -	270 / 69.573

*Title represents 1) the Number / Title for Items; 2) the Number / Title [DODIC] for Ammunition; and/or 3) the Number / Title (Modification Type) for Modifications.

Note: Totals in this Exhibit P-40 set may not be exact or sum exactly due to rounding.

Justification:
 FY 2025 Base procurement dollars in the amount of \$69.573 million supports SRR, Company Level SUAS DR and COTS UAS.
 -\$21.073 million for procurement of 270 SRR Tranche 2 Systems (system consists of 2 air vehicles, 1 Handheld Ground Control Station (HGCS), Digital Data Link (DDL) and Electro-Optical/Infrared (EO/IR) Payload). Remaining funding is for initial spares packages, training, fielding, technical and program support. This is an increase from the FY 2024 requested level to support Army requirements.
 -\$25 million for Company Level SUAS DR
 -\$23.5 million for the Chief of Staff of the Army's COTS UAS unit training initiative.

Starting in FY 2023, funding was moved from A00010 to A12511 for SRR.

In accordance with Section 1815 of the FY 2008 National Defense Authorization Act (P.L. 110-181), this item is necessary for use by the active and reserve components of the Armed Forces for homeland defense missions, domestic emergency responses and providing military support to civil authorities.

Footnotes:
 (8) The correct P-5 Gross/Weapon System Unit Cost for FY 2023 is \$51.198K.
 (1) The correct Gross/Weapon System Cost for FY 2023 is \$10,598K.
 (2) The correct Net Procurement for FY 2023 is \$10,598K.
 (3) The correct Total Obligation Authority for FY 2023 is \$10,598K.
 (4) The correct Gross/Weapon System Unit Cost for FY 2023 is \$51.198K.
 (5) The correct Secondary Distribution Army Active Total Obligation Authority for FY 2023 is \$10,598K.
 (6) The correct Secondary Distribution Total for FY 2023 is \$10,598K.
 (7) The correct P-5 Gross/Weapon System Cost for FY 2023 is \$10,598K.

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Source: US Army [Aircraft Procurement FY 2025 Budget Estimates Justification Book](#)

But back to the SRR and the actual program terms. Red Cat's management claimed that if you just look at the draft NDAA (National Defense Authorization Act), which has since passed, "the number" for the SRR funding is \$79 million, which the company uses as an indication of what to expect for the first year's revenue generated by the program. Here too, we're not sure if it's malice or incompetence, but the NDAA never says anything about \$79 million for the SRR. The [draft NDAA](#), as well as the [final bill](#), provided for \$69.6 million for "small unmanned aircraft systems" (sUAS) on the procurement line and another \$39.7 million for "small unmanned aerial vehicle" research, development, testing, and evaluation (RDT&E). The Army publishes its detailed budget request justifications and in the [2025 materials](#), it lays out how much of that \$110 million was requested (and granted in the final bill) for the SRR:

- \$17.55 million for 270 SRR systems at an assumed cost of \$65,000 per system.

- \$3.52 million for spares, logistics, training, and support.
- \$0.81 million for SRR development, testing, and evaluation.
- \$3.86 million split between the SRR and two separate Army UAS programs for systems engineering program management. Of this, we estimate that under \$1 million is earmarked for the SRR and the rest for the two other listed programs.
- \$0.53 million for miscellaneous SRR-related RDT&E

In total, that's about \$23.5 million that the Army is planning on investing in the SRR for FY 2025, including the procurement of 270 systems and spares. We can't be certain, but we think that

1. The "\$79.5 million" mentioned by Red Cat's management was a misreading or misremembering of the \$69.57 million on the "Small Unmanned Aircraft Systems" procurement line item in the draft NDAA.
2. Either no one at Red Cat bothered to look at the details of the request, or they did and felt no need to inform investors of what the number actually refers to. The Army budget request is very explicit in splitting the \$69.57 million among *3 separate programs* (see the copy of the relevant request on the previous page): The SRR, the so-called "Company Level SUAS" program (also known as the medium range reconnaissance program, or MRR), and the Army's "COTS UAS training initiative," which is meant to train Army personnel operating commercial off the shelf (COTS) drones. SRR procurement funding is set at \$21.07 million.

We would note that the \$21 million is a statutory *ceiling*. It's neither a guarantee nor a minimum. The Army is likely to approach Tranche 2 of the SRR with Red Cat the same way it approached Tranche 1 of the program with Skydio: by signing a multiyear contract with a ceiling and a minimum. With Skydio, the Army signed a 5-year firm-fixed-price contract worth *up to* \$100 million and a minimum of \$20 million. It ended up buying just \$48 million over just about 2.5 years. In the 2025 budget documents, the Army remains noncommittal about the future years of the SRR program and lays out its expectations for acquiring between 265 and 300 systems per year between 2026 and 2029, which obviously amounts to nowhere near the headline 5880 systems. Red Cat's price per system at \$45,000 is quite a bit lower than the Army's expected \$65,000, so the quantity procured could be higher than currently anticipated, but the *dollar* budget for the SRR seems to be \$20-25 million annually – *not* \$79 million, or even \$50 million.

Red Cat Teal's SRR contract will be shorter and less exclusive than they've implied

It's also not really true that SRR Tranche 2 is a *5-year sole-source program*. What's true is that Red Cat will probably sign a *5-year sole source contract*. Those are two different things. Skydio also signed a 5-year sole-source contract, but the Army decided not to continue with Skydio midway through the five years. The Army has made clear through direct commentary, program specs, and responses to media inquiries that future UAS procurement will feature:

- Rapid (relatively, at least) program upgrades on the order of every 2-3 years – In a [media report](#) at the end of October 2023, the Army's assistant product manager for the SRR project stated that "This will always be the formula to success for us, **a creative acquisition**

pathway every two to three years providing a new capability to the soldier and replacing the older ones through attrition.” This isn’t even very controversial: three months earlier, after the Army combined Tranches 2 and 3 of the SRR program into a single Tranche 2, Red Cat CEO Jeff Thompson explained that the new combined procurement “is for approximately 12,000 drones and **has been extended to almost 10 years. There is usually a 3-year replacement cycle in programs of this size.**” Of course, that’s inconvenient to admit right now.

- Flexible contracting with the possibility of rapid vendor changes – in an Army [commentary](#) published this past October about the necessity of rapid adaptation in UAS procurement, three generals involved in the effort explicitly described an “Adaptive Acquisition Framework” through which the Army would “continue to speed up and optimize its approach to acquisition” through flexible contracting that would allow for intra-program vendor changes:

Advances in UAS, sensor, and software technologies is occurring faster than traditional, linear procurement processes can react. The Army’s Program Executive Office for Aviation is **embracing innovative, parallel approaches to employ the new ways of doing business...**This approach not only supports rapidly integrating hardware and software but also **employs a business strategy that allows it to quickly maneuver, both contractually and programmatically, to on-ramp and off-ramp vendors and meet future UAS requirements. This strategy allows the Army to contract directly with multiple industry partners that can supply technologies...**The Army is also leading **a unique contracting approach by leveraging multiple contracts, instead of a sole, vendor-locked agreement with an original equipment manufacturer,** to quickly and economically incorporate the market’s best available technologies and expertise...

- Procurement of interoperable systems – In that same commentary, the generals also lay out the UAS Project Management Office’s “Modular Open Systems Approach (MOSA),” explaining that the Army is “enabling agile integration of technology by **establishing MOSA ‘use cases’ as a primary evaluation factor in the source selection...**Industry **must demonstrate through their technical proposal and data assertions that the Army will be able to meet MOSA** and sustainment goals.” In other words, part of the criteria vendors have to meet is their ability to obsolete themselves by making their systems modular.

We have corroborated all this with several defense industry procurement experts. About the Army’s obligation to Teal/Red Cat, one expert told us

A lot of these programs, SRR included, are built around a capability, not a specific platform. So the way they say it within DoD is currently for SRR, the material solution is the Teal black widow. That material solution can change, and in most programs, there's not a requirement for there to be a single material solution...there's also an aspect, in this case, of the DIU'S Blue UAS stuff, if there's stuff on there...because DIU is doing a yearly refresh of that is their new methodology - so SRR naturally is going to look at what platforms are being submitted to that and they'll have a continual database of what

platforms are out there and if they see something they like, then that could be the starting point for them wanting to push for [Tranche] three and what that comes back as.

Another procurement consultant explained that

There is no guarantee that even once the contract is definitized - because there's a five year order period on the tranche two contract - 1) that that many tranche two units will be procured and 2) that they will be procured from Red Cat Teal. As you read the press coverage, you saw and in fact, at a recent conference here in Austin, the Army Futures Command, on the very subject of SRR, *the chief of staff of the Army Futures Command, a three star general, said specifically "we may very well be making awards to additional tranche two offers. Or we may do yet a third competition and either call it tranche 2a or tranche three of SUAS."* All of that's gonna revolve around this development of organization and tactics, techniques and procedures and integration of SRR, not only into that hierarchy of drones that we talked about, but also into the wider battlefield command and control system.

With respect to that last point, given the novelty, urgency, and breadth of the DOD's recent push into drone incorporation into the military, the Army hasn't yet fully fleshed out how it's going to incorporate the SRR into its operational framework, which means that the risks of the program changing are higher than usual.

• • •

That the SRR program's financial benefit to Red Cat is being massively overestimated by the market is not that controversial among other industry players who have considered competing for the program. Aerovironment, the largest pure-play publicly traded unmanned military vehicle company, said the following in its December 4th earnings call:

We intentionally chose not to compete for that program [the SRR]. It is a different set of capability that we strategically decided a while back that that's not a market that we're going to go very strongly on initially. There are several factors on the reasons why. A) making money in that market and that business is not an easy thing. And if you look at the financials of some of these companies, it's very evident in that regard. B) we see that we can deliver a lot more value for our customers and our shareholders with focusing on much larger and more systemic areas of demand globally that we can deliver a lot more value to all of our customers as well as shareholders. So we did not compete in that opportunity.

Basically, the SRR is a tough business and it's too small to matter. On the other hand, Aerovironment made it clear that they do intend to compete for the *medium* range reconnaissance (MRR) program, which they assessed as a billion dollar decade-long program. If the SRR were actually a third of that dollar value over just 5 years – the implied claim Red Cat made – you can be sure other, much more technologically advanced companies like Aerovironment, Teledyne-FLIR, Anduril, etc, would be competing for it. Instead, only small

companies competed for the program and there's no one except for Red Cat that's claiming it's a huge deal.

Which is a good segue into asking an obvious question: why is the size of the deal even up for debate? Aren't defense deals like this supposed to be announced in a DOD-approved press release with some financial details, kind of like the Skydio contract? On the day after Red Cat announced its win, defense industry news site *Breaking Defense* [reported](#) that "after [Red Cat] preempted the service announcement on Tuesday, the Army confirmed today that it had selected Red Cat's quadcopter for SRR but noted that 'exact funding, quantities, and other details' will be hammered out throughout the rest of the year as the duo work through the contract details." The Army refused to confirm the details that Red Cat claimed in its press release and conference call. In discussions with defense industry participants, we discovered that those who were familiar with the SRR program dynamics all knew that Red Cat had improperly announced the program win without the Army's approval. One consultant told us:

Here's a thing that I don't notice that the popular and even some of the professional press has really realized about SRR Tranche 2: First of all, Teal Red Cat shot their mouths off and announced the award before the Army told them they were allowed to. Whenever you win a contract, the first thing you do is you write the press release and you send it to the customer and it takes six weeks to three months for the customer to finally approve you announcing that you've gotten contract award. The solicitation makes very clear...that you cannot make any announcements without...permission of the government. I think they're in a bit of hot water over that. The acquisition regulations actually require that the government notify Congress before they notify the contractor and before the public is notified...this has happened to me many times in awards that I've won, the government calls you and tells you that you've won, but you can't tell anybody yet...you can tell your employees, but you may not make an announcement, we haven't notified Congress yet. Red Hat went off halfcocked...I am quite sure that the...procurement contracting officer called the contracting manager at Red Cat and said, don't you ever do that again. We just might pull your contract. You don't have a contract yet until we have negotiated...You had no business shooting your mouth off. Your award is actually threatened...I don't think they'll lose the award as a result of that. But I think the action by Red Cat of going off halfcocked has made the environment in which the definitization negotiation will be much more strained than it needed to be...

We suspect that part of the reason Red Cat made an unapproved announcement was that a vague press release with no details beyond "5,880 systems" would be a lot more impressive than a detailed contract award announcement in which the most salient feature would be the underwhelming financial aspects of the award compared to what Red Cat management had previously guided.

In the end, we believe that much of what Red Cat has led investors to believe about its SRR win is either exaggerated or just plain wrong. Red Cat will likely have 2-3 years of SRR program exclusivity and sell up to \$25 million worth of drones per year over that time. Maybe a bit more if the Army quickly figures out how it intends to deploy the drone in training and combat. Then,

Red Cat will have to compete for the upgrade contract, which they may or may not win, but which will be a lot more competitive if the SRR becomes a significant program. Even putting generous margin assumptions on that, it's obvious that the market having added \$600 million in value to the company since November 19th is ludicrous.

IV. Red Cat has a Long History of Setting Misleading and Unrealistic Expectations

Some Red Cat investors seem to have taken solace in the company's revenue guidance of \$50-55 million for calendar year 2025 *excluding* any contribution from the SRR. While taking that guidance at face value would still mean that Red Cat trades at 12x this year's revenues, there's absolutely no reason to expect that Red Cat will come anywhere close. It's true that for two quarters of the 2024 fiscal year Red Cat beat its own guidance by a whopping \$1.7 million (combined). But management has a track record of making grandiose announcements that end in disappointment. As we detail below, this dynamic has been most evident in the company's running commentary on its manufacturing capabilities and sales channel expansion.

Despite years of claiming that mass production capabilities are imminent, Red Cat's manufacturing capacity is likely undersized

Over the course of 2022, in the wake of Red Cat's acquisition of Teal, the company updated investors on the status of manufacturing upgrades at Teal's Salt Lake City facilities in each of their quarterly earnings calls:

February 9th, 2022: We're in a really great place with having the manufacturing being built out in Salt Lake City at the Teal factory... ***The production line that we're building, by the way, can do up to 2,000 drones a month.*** We're not there yet...but that production line will be able to do 2,000 a month...we've doubled the size of the production facility so that ***once we get to the max that we can on this existing production line, we're actually going to build another one in the same facility.***

March 17th, 2022: During the quarter, we doubled the size of the Teal facilities, both to increase its manufacturing output capabilities as well as to house its workforce... we've been making a lot of capital investments in Teal, both in its facilities and its people to take advantage of what ***we see as significant commercial opportunities for the Golden Eagle...We're keeping our heads down and getting our manufacturing capability to be able to put out thousands of drones a month.***

July 27th, 2022: The Teal Drone production line is in full swing and producing high-quality drones. ***We expect to go into mass production in the fall.***

September 12th, 2022: We are currently switching from PVT: production validation tests to ramp and mass production... We hope to have the construction done in the next month or 2 and put this behind us, **and that will also bring us into full mass production... Mass production enables Teal to continue to improve ongoing yields, qualify additional tools or vendors, make design changes based on customer feedback, any early field failures or cost-down efforts... We believe that having a maiden USA factory up and running at mass production is a strategic advantage for the RFPs we are working on and the Tranche 2 production contract...** if we win Tranche 2, we'll be capable of basically hitting the ground running and produce this drone as quickly as possible... So that's a very early stage production line, which is now maturing... **now we basically fix any issues and problems and vendors and tooling that we want to do to automate the production line so that we can really scale it...** if we get any of these RFPs, we're going to have to start producing a lot of drones very quickly.

It sure sounds like over the first 3 quarters of the year, Red Cat spent a lot of time and money at Teal's facilities installing at least one major production line that's capable of manufacturing thousands of drones per month and that the construction will be complete by the end of October. In a call at the end of November, it sounds...confusing:

November 29th, 2022: We're reporting here live from the Teal factory... **We are about to start being able to ship over the next 4 to 6 weeks, the brand new bird that we've been working on... So the factory is going to be basically in full swing. It's starting now, and we'll be able to produce thousands of drones per month if we have the orders for them.** We have the inventory. We have the parts, we have the capital... So the factory is doing awesome...we're at low rate production right now, and we'll carry that forward for a few months just to be sure that all our fixtures and everything mature and our product quality is high, and then we'll be able to turn it on.

On the one hand, Red Cat Teal is ready to begin shipping the Teal 2 in a few weeks ("if we have the orders for them"), which indicates "the factory is going to be in full swing." On the other hand, it sounds like Teal is still only running "low-rate production," focused on ironing out any kinks over the next few months and only then will be able to "turn it on." Which is it? We wanted to highlight that because the contradictions get worse over the course of time, but that question in particular seems like it gets a definitive answer on the next earnings call:

March 7th, 2023: The Salt Lake City factory is complete and ready to go. We now have a state-of-the-art drone factory. We have chips to make thousands of drones, and we're only producing the new Teal 2 drone with the new camera payload. **The Teal team has done an incredible job completing this in just 12 months. We now have the capacity to produce thousands of drones per month.**

That seems very unequivocal. Yet in an earnings call a few months later, CEO Jeffrey Thompson seems to have implied that it's not so easy to get to 1000 units manufactured per month:

July 27th, 2023: ***we do 100 a month no problem at ease right now. And that number is already growing slightly. But what you can't -- you don't often build 1,000 drones*** because there's different frequencies like, so for instance, some of the organizations that we've been working with for demonstrations to hopefully get in sweeps relatively soon, 1.8 gigahertz. Some of them want 2.4 gigahertz. Some of them want other frequencies that we're not really talking about for other countries. ***And so you can't just make huge batches and hope for the best of 1,000 and they ship them out.*** But we've been at a good clip, and we can expand that capability. ***If we had to, if we got an order for 1,000, we would ramp that up dramatically in a few months.***

As a follow-up to that, then-CFO Joseph Hernon seemed surprised at the investor question, exclaiming that ***"I don't personally recall us ever saying we could produce 1,000 a month. 1,000 a month at \$15,000 per drones, I don't have a calculator in front of me, but that's an incredible amount of revenue."*** If this seems confusing or dishonest (or both), it gets worse. On an earnings call in March of last year, the production commentary was as follows:

March 18th, 2024: ***The production facility in Salt Lake City is in full mass production mode.*** We are now running 1.5 shifts to meet production goals as we continue to invest in facilities, people and processes. ***We are now demonstrating that we can build tens of thousands of drones yearly.***

In theory, this had already been demonstrated or accomplished several times (the fall of 2022 or Spring of 2023), but perhaps now – as of early 2024 – it's finally true? As of September of 2024, production scaling still seems to have been unfinished:

September 23rd, 2024: Our management, engineering and manufacturing teams ***quickly developed a plan to scale production for 2025.*** Over the past 4 months, our engineering and manufacturing teams have ***been retooling and preparing for high-volume production.***

[In explaining why sales didn't meet guidance:] ***The pause in manufacturing of Teal 2 and building Army prototypes impacted Teal 2 sales*** in 2 ways. ***First, we couldn't produce and sell Teal 2 units while retooling our factory...Looking to the future, we have been preparing manufacturing of our latest product, which we're calling the Teal 3 for right now. We expect to produce this drone for several years, which will allow us to steadily increase margins over time.***

The commentary there about “preparing for high-volume production” is puzzling. Red Cat has been preparing the Teal facility in Salt Lake City for mass production (and even declared mission accomplished at least 3 times) for almost three years if you take management at its word. It's also surreal for Red Cat management to say they needed to cut back on sales of the Teal 2 because of a pause in manufacturing. Back in September of 2022, management was explaining how the investments they'd made in their manufacturing that year were meant to

“enable design changes based on customer feedback.” The whole point of having several advanced high-volume production lines was that manufacturing wouldn’t need to be paused to enable the manufacture of a slightly redesigned product.

What should investors make of management constantly contradicting, revising, and sometimes outright denying clearly recorded definitive claims they’ve previously made? The most obvious takeaway is that Red Cat’s management team is simply not credible. They’ve consistently given a totally unrealistic and misleading indication of their revenue opportunity by talking about how much they’re going to be able to manufacture in the future. “We’ll be able to manufacture thousands of drones a month” is not *exactly* the same thing as saying “we’ll be able to generate tens of millions of dollars a month in revenue” but it’s close enough while allowing for plausible deniability about the precise timing and scale of revenue. The “future” just keeps getting pushed further and further out.

Where is Red Cat in its quest to attain the capability for mass production? In the course of our due diligence, we found a drone industry specialist who’s been following Teal since its founding by Matus and who had the utmost admiration for what he’s accomplished. They were adamant that there’s just no way that Teal is capable of any sort of mass production, though a contract like the SRR that calls for 30-50 units a month is definitely achievable. Red Cat’s financials seem to confirm this assessment: Over the 3 years ending on October 31, the company has spent a mere \$3.1 million on capital expenditures, *with over two thirds of that before the end of 2022*. It’s highly implausible that a mass-production facility for manufacturing drones has been built at any point in the last two years for less than \$1 million. Like the talk about the size of the SRR contract, what Red Cat’s management repeatedly said about manufacturing capacity has been bluster unsupported by the facts. The same is true of the sales channel.

The sales channel for small \$15,000 drones is very narrow

A major point that Red Cat management stressed on the SRR Town Hall conference call was that the stamp of approval from the Army would open up sales opportunities with the other US military branches, as well as non-military US government agencies and US-allied militaries:

So the fact that having the program of record and the Army investment on the R&D to come to a selection of us, which we appreciate, ***now opens the doors for the other services to adopt that program of record potentially*** and do their own fielding upwards and in addition to what we’re going to be doing with the Army.

Now that this program has been awarded to us, USG outside of DoD is going to be looking at “okay, the Army went through this five-year process to pick Teal, must be good enough for us.” So, we expect adoption through many of the USG offices... Department of Interior would be a big one, Customs and Border Protection, DHS in general has got 16 organizations underneath it. So, everybody has patiently been

waiting for the Army to announce, and they finally have, so now we can announce. And we expect growth in all of the USG sectors as well.

NATO has been waiting patiently for this announcement, again, because if the US has invested all of this money to go through an entire five-year down select process, they're going to start adopting what has been approved by the Army because all the research development has been paid for and all the evaluations have been completed by them...we have several very, very large opportunities right now in NATO that have patiently been waiting for this announcement...a few of those programs that could eclipse the SRR program in size and dollars.

It's hard to keep up with all the hyperbole, so let's take each of these claims in turn. The idea that "other services" will now be interested in the SRR is just ridiculous. Both the Air Force and the Navy (including the Marines) have highly developed drone programs, none of which include any of the kind of drones that the SRR program is meant to procure. The Air Force obviously has a very limited need for a drone that's supposed to be fielded by ground troops as part of a platoon.³ As for the Marines – basically the infantry branch of the Navy – the force does have a "Short Range/Short Endurance" (SR/SE) UAS program that a) has specification requirements that Teal's Black Widow doesn't meet, b) has a \$10 million budget, even smaller than the Army's \$25 million, and c) is already [served](#) by UAS models from FLIR (the [Skyranger](#) and [Black Hornet](#), the latter also the Army's choice for the squad-level UAS) and [Lockheed](#).

Red Cat's claims about potential sales to other US government agencies are only slightly more realistic. The Department of Interior – which oversees National Parks and Forests, Wildlife, Oceans, etc. – has a UAS fleet that in total numbers about 800. The GAO [reports](#) that rules prohibiting the acquisition of Chinese drones have made it difficult to replace aging drones because approved American drones are just too expensive for DOI's budget. Even in the unlikely event that the funding spigots opened and DOI could go back to purchasing 200 drones annually as they were before the foreign drone rules were enacted, the nature of the Department's [current UAS fleet](#) suggests that a) only a fraction of the vehicles procured would be in the same class as the Teal 2/SRR and b) that the DOI has already chosen the Blue UAS-approved [Parrot Anafi](#) – which wholesales for \$7,000, or half of the Teal 2 – for those purposes.

The reference to the Department of Homeland Security's "16 organizations underneath it" is another instance of a grand pronouncement with little underlying substance. All of DOH's subsidiaries [publish their budget requests](#) and only 2 requested funding for UAS procurement in Fiscal 2025 – the Coast Guard and Customs and Border Protection (CBP). The Coast Guard's UAS funding [request](#) is for a *servicing* contract and amounts to a negligible \$750 thousand.

CBP's request is a bit more interesting because Red Cat has been talking about selling drones to CBP since at least late 2021 when it [announced](#) a \$90 million contract over 5 years with CBP.

³ Yes, the USAF technically does have ground troops for special forces operations, or to embed within Army units to coordinate with the Air Force, or for a variety of other reasons, but the Air Force does not have infantry, and the SRR is meant to support reconnaissance objectives of infantry platoons.

For 2025, though, CBP [requested](#) *zero dollars* to procure small UAS, but it disclosed in the notes that it plans to use prior years' funding to procure 60 Blue sUAS. Even if all of those were Teal-2s, that would be just \$900,000 in revenue, but there are currently 13 other non-Red Cat drones on the Blue UAS list and it's not at all obvious that CBP will choose Teal. As for that \$90 million contract Red Cat won in 2021, the company's 10-K actually discloses that the \$90 million was a ceiling, that the "win" was a "multiple-award" contract in which 4 other companies were also chosen, and that the total amount that has been awarded so far to Teal (back in 2023) was \$1.8 million for 54 systems/110 drones - 98% less than the initial pronouncement.⁴

Finally, let's assess Red Cat's claim that the SRR win opens the floodgates for sales to US-allied militaries, including "several very, very large opportunities right now in NATO that have patiently been waiting for this announcement," some of which "could eclipse the SRR program in size and dollars." While it's certainly *possible* that there are some large opportunities in Europe that are larger than the SRR, we haven't been able to find any, and their existence seems unlikely especially considering that Europe's UAV market is both smaller and more fragmented. "The average value of each European UAV programme is *less than half that of its North American counterpart*," reads a [recent analysis](#) by two European UAV experts (emphasis ours).

Europeans also seem a lot less worried about the security implications of procuring Chinese drones, at least after modifying them. The German military recently published [framework agreements](#) that it signed with two German suppliers allowing the military to acquire *commercially available* sUAS from them in the same category of drone as the Teal 2 and SRR. The two drones allowed under the agreement are both produced by Chinese manufacturers (Autel and DJI) but supplier modifications allow for their inclusion on the *German* "so-called Blue List." Both drones cost \$5,000 to \$10,000 each, depending on the feature set, and have at least some specs – such as flight time – in which they're clearly superior to the Black Widow. It's going to be hard for Red-Cat-Teal to go up against a superior product that costs 50-75% less.

Another good indication that these supposed NATO procurements weren't exactly "patiently waiting" for the SRR award is that – like the mass production capabilities and the CBP contract-that-wasn't – Red Cat has been talking about them for years. A sampling:

March 17th, 2022: we have been getting inquiries from direct phone calls into our biz dev team...that resulted from our almost **3-week tour in the NATO countries that we visited**...I've had people find my number on LinkedIn to call me from different departments of state ex ambassadors. We've had over almost 15 inbound inquiries from

⁴ On the March, 2023 earnings call in which the company announced the 54-system sale to CBP, CEO Jeffrey Thompson mentioned in the Q&A that "what we've gathered from our meetings is [CBP] typically has about 400 drones that are in service, and they need to have 200 or so other drones to make sure those 400 always stay in service. So I think the total addressable market for the Border Patrol could possibly be close to 600 drones." By TAM, he of course didn't actually mean *annual* sales but CBP's total fleet size, which means that the annual sales opportunity is a lot smaller than 600 drones. 50-100 per year seems about right.

not all different countries...3 or 4 sometimes from the same country, **but the demand is just kind of overwhelming** that everyone is realizing that no one wants to use Chinese drones to help over in Ukraine...We don't have anything to announce yet. As soon as we get some signed POs [purchase orders], **we're not giving these birds away. We're selling them. And as soon as we have POs, almost every one of the ones that we're talking about are all material contracts if we can get them signed. So you'll probably be hearing about that soon...**I pretty much think every drone that we can make will be sold over the next 12 months and going forward. It's -- the demand is there...specifically over in Ukraine, **they would love to have thousands of Teal Golden Eagles with thermal right now to really help what they're doing.**

September 12th, 2022: ...we've applied for a lot of RFPs to a lot of Eastern European countries. **We have a couple for about 600 systems, some for 300 systems and 2 for over 2,000 systems.** So we don't expect to win every single deal and some of them will probably be multi-vendor. But these are large, large possible proposals and contracts that we could win and **being a maiden USA company and approved by the DoD, we think, gives us a strong position to do so...a couple of them, we hope to hear within about a month...So we don't give guidance yet, but we have probably close to over 3,500 drones in proposals right now.**

November 29th, 2022: **We're working with many NATO countries, and they're basically RFP processes like we have here in the U.S. We have some pretty significant large RFPs we're participating in,** and we're just getting through certain phases. **We've been downselected by one of the NATO countries for a pretty large program. So we're excited about that...So we expect to have a pretty strong sales year in 2023, specifically with the new Golden Eagle bird that has this incredible new payload and camera.**

March 7th, 2023: The previous 2 weeks, myself and the business development team have been to at least 5 different countries. We believe it's been a very successful trip, and the Teal 2 drone is getting a great response from operators and warfighters. **We also received initial orders, and we believe we are well positioned to be awarded a sole-source contract, sole-source contract for hundreds of drones. Red Cat also became certified in the European country to be included in their defense catalog, breaking the log jam to be able to sell to these European countries. And finally, we have identified opportunities to get the new Teal 2 to the Ukrainian warfighters.**

March 18th, 2024: Our business development team has done a great job and as they tell me this will be the year of international...Our bizdev team has been working on more than 10 large RFPs for more than 18 months. **And to be frank, a lot of them are larger than SRR. Some of these RFPs are supposed to pop soon and could be our largest contracts yet. So the work we've done over the last year, almost 2 years on some of these RFPs, are set to be announced winners later this spring.**

August 8th, 2024: Red Cat is also in late stages for NATO programs of record. We believe that they are also significantly larger than the U.S. SRR program of record.

These programs are expected in the next 2 months to have their down selection.

It's frankly just comical. In *March of 2022*, Thompson was talking about selling every possible drone Red Cat can make to European customers for Ukraine. 3500 drones in proposals in September of 2022. "Expecting significant sale" with European customers in 2023. "We...received initial orders" in March of 2023 (that's *almost two years ago*). "RFPs are supposed to pop soon...set to be announced in the Spring" of 2024 (that was *last year*). Of course, none of these ever happened.

The idea that there's some vast market for \$15,000 - \$20,000 drones *anywhere* outside the SRR program is a mirage. Red Cat has been talking about these forever to gin up investor excitement. They're always *just* around the corner but somehow...disappear.

About that Guidance

Going back to Red Cat's \$50-55 million revenue guidance for 2025 (excluding the SRR), Red Cat explained in their late September earnings call that this is comprised of \$5-8 million in revenue from their FPV drone, and the rest they expect to be evenly split between the Teal-3 (the Teal-2 successor) and the Edge 130.

Regarding the FPV drone, we'll only note that this product doesn't currently exist. The Red Cat website that showcases its [Arachnid family of products](#) shows the Fang FPV drone as "under development and undergoing Blue UAS certification." In July, Unusual Machines [announced](#) that it would be directly supplying Red Cat with the FANG drone, but in UMAC's November earnings call the company expressed disappointment that the DOD would not be spending anything on FPV drones for 2025. We're not certain who Red Cat is selling this not-yet-existent drone to, but it probably won't be the DOD so we'd take that \$5-8 million guidance with a grain of salt. We also wonder about the profitability of a product on which Red Cat seems to be acting as merely a glorified distributor.

The Edge 130 guidance – which comes out to something along the lines of \$20-25 million in revenue – is more significant and a bit perplexing. The Edge 130 is a drone developed by FlightWave Aerospace Systems in [2019](#). FlightWave [agreed](#) to be acquired by Red Cat for \$14 million in Red Cat stock in early June of last year with the transaction [closing](#) in early September. As of the end of October, FlightWave has never generated any meaningful revenue. In fact, based on the comments from Thompson on the December earnings call, it doesn't seem like Flightwave has *any* manufacturing facilities and has only been operating prototypes:

When do you think the FlightWave factor will be up and running? That's a good question. ***So we are just starting to move in now. We just signed a lease. We hope to have more of a start-up style factory in about 3 or 4 weeks where basically, they're***

sitting on top of each other in their office right now. They'll be able to spread out, put a bunch of tables out there and just get a production line that's mapped out. And then it will look like a real factory like the Teal factory, hopefully, in about 2 months.

So probably (maybe?) as we speak, FlightWave has a “startup style factory” where they’re assembling drones on “a bunch of tables.” Where is the factory being built? FlightWave was based in Santa Monica, but the company’s website now lists a single address – 370 Harbour Drive, Palmas del Mar, Humacao, PR 00791. That’s right on the beach at Palmas del Mar in Puerto Rico, about 40 miles away from Red Cat’s headquarters in San Juan, and it’s a strange place to build a drone factory. Either way, Red Cat – a company whose most successful product ever, the Teal 2, sold about \$17 million over the course of about 18 months, and which has never been able to construct a high-capacity manufacturing facility – is going to take a different company in a different time zone that has never built anything beyond a *prototype* of a complex VTOL-plus-forward-flight design and in two months build a production line capable of \$25 million in annual revenue? We are...skeptical.

The final \$20-25 million portion of Red Cat’s non-SRR 2025 guidance is meant to come from the Teal 3, another product that as far as we can tell has only been discussed on Wall Street conference calls and not yet officially being produced. We’re not really sure how Red Cat intends to produce both the Teal 3 and the SRR. On the December earnings call, Thompson talked about “just stamping out the same aircraft [the SRR] quarter after quarter, so excited that we don't have to switch aircraft for the first time ever and just build this airframe that's going to be so important to the industry.” How is it possible that (i) they had to stop production of the Teal 2 in order to retool the factory for the SRR and that the SRR will be the only product manufactured in the Teal facility, but *also* that (ii) the Teal 3 will generate \$20-25 million in 2025 revenue as it’s manufactured simultaneously with the SRR? It’s confusing, but this all makes more sense if we just assume that not all of it is actually going to occur.

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Red Cat management’s track record for accurately guiding investors as to future operational developments leaves a lot to be desired. This is likely due to some combination of dishonesty and incompetence. Much of what management has forecasted or hinted to over the last 3 years has failed to materialize in a way that matches the original claims. The company has either missed or withdrawn guidance for the last 3 consecutive quarters and its guidance for 2025 is unrealistic. Don’t be surprised when they badly disappoint.

V. Conclusion

Less than a week after Red Cat’s SRR announcement, George Matus resigned. As Teal’s founder and Red Cat’s CTO, Matus was the brains behind the SRR. Just last May, he signed an employment agreement that granted him 900,000 Red Cat shares. Given his now considerable financial stake in Red Cat’s future as well as his operational control over the platforms at the

heart of the company's future – the SRR and Teal 3 – his resignation appears baffling at first glance. It makes a lot more sense, though, in the context of the original Teal acquisition and its terms. Recall that Matus had negotiated to receive millions of dollars of Red Cat stock in the event that the Golden Eagle had cleared certain revenue hurdles. None of the revenue hurdles were ever cleared, though, and Matus had his first experience with management's grandiose assurances ending in disappointment. As we chronicled in this report, that pattern played out repeatedly since the acquisition of Teal in a host of different areas – manufacturing capacity, sales channel expansion, and customer acquisition, to name a few.

While the SRR win is real, its scope and its potential to bring in new customers have been vastly overstated by Red Cat's management, and we believe Matus knows this. Given the stock market reaction, Matus was able to take his cards off the table and cash out: in December, he sold 800,000 shares at an average price of \$11.75. The fact that he left Red Cat to help found a new company is further confirmation that his resignation is a vote of no-confidence in Red Cat's future. Despite his LinkedIn protestations to the contrary, his actions speak volumes.

So too do those of CFO Leah Lunger, who resigned in mid-December and summarily sold the majority of her shares, as well as other members of Red Cat's management and board – including CEO Jeffrey Thompson – who have sold about 1.6 million shares since the SRR announcement. In the next few weeks, Red Cat will be finalizing its SRR contract with the Army. The official announcement made by Red Cat will probably follow the historical pattern – grand announcement with impressive headline numbers, but details that are less than meets the eye. Don't be fooled. Red Cat's future is going to look very similar to its past: high hopes grounded by reality.

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