Taser International, Inc. began operations in 1993, and completed an initial public offering in 2001. The firm is the developer and manufacturer of less-lethal self-defense devices sold to law enforcement agencies, commercial airlines, the military, security firms and individuals.

Required

1. Analyze the firm’s financial statements and supplementary information on pages 242–248.Your

analysis should include the preparation of common-size financial statements, key financial ratios, and an

evaluation of short-term solvency, operating efficiency, capital structure and long-term solvency, profitability, and market measures. (The financial statement analysis template can be accessed and used at www.prenhall.com/fraser.)

2. Using your analysis list reasons for and against investment in Taser International, Inc.’s common stock.

3. Using your analysis list reasons for and against loaning Taser International, Inc.

additional funds.

**TASER INTERNATIONAL, INC.**

**STATEMENTS OF INCOME**

 For the Year Ended December 31, 2004 2003

Net Sales $ 67,639,879 $ 24,455,506

Cost of Products Sold:

Direct manufacturing expense 16,898,559 6,973,757

Indirect manufacturing expense 5,556,937 2,428,859

Total Cost of Products Sold 22,455,496 9,402,616

Gross Margin 45,184,383 15,052,890

Sales, general and administrative expenses 13,880,322 6,973,721

Research and development expenses 823,593 498,470

Income from Operations 30,480,468 7,580,699

Interest income 439,450 50,375

Interest expense (1,485) (9,307)

Other income (expense), net 2,309 (254,476)

Income before income taxes 30,920,742 7,367,291

Provision for income tax 12,039,000 2,913,601

Net Income $ 18,881,742 $ 4,453,690

Income per common and common equivalent shares

Basic $ 0.33 $ 0.12

Diluted $ 0.30 $ 0.10

Weighted average number of common and common

equivalent shares outstanding

Basic 57,232,329 37,889,640

Diluted 62,319,590 46,598,312

**TASER INTERNATIONAL, INC.**

**BALANCE SHEETS**

December 31, 2004 2003

*Assets*

Current Assets

Cash and cash equivalents $ 14,757,159 $ 15,878,326

Short-term investments 17,201,477 —

Accounts receivable, net 8,460,112 5,404,333

Inventory 6,840,051 3,125,974

Prepaids and other assets 1,639,734 536,815

Income tax receivable 52,973 292,321

Deferred income tax asset 11,083,422 1,137,196

Total Current Assets 60,034,928 26,374,965

Long-term investments 18,071,815 —

Property and Equipment, net 14,756,512 3,946,881

Deferred Income Tax Asset 15,310,207 —

Intangible Assets, net 1,279,116 1,122,844

**Total Assets** $109,452,578 $31,444,690

*Liabilities and Stockholders’ Equity*

Current Liabilities

Notes payable $ — $ 250,000

Current portion of capital lease obligations 4,642 15,223

Accounts payable and accrued liabilities 8,827,132 3,444,346

Customer deposits 102,165 185,802

Total Current Liabilities 8,933,939 3,895,371

Capital Lease Obligations — 3,655

Deferred Revenue 607,856 78,093

Deferred Income Tax Liability — 40,121

**Total Liabilities** 9,541,795 4,017,240

Commitments and Contingencies

Stockholders’ Equity

Preferred Stock, $0.00001 par value per share;

25 million shares authorized;

0 shares issued and outstanding at December 31, 2004 and 2003 — —

Common Stock, $0.00001 par value per share;

200 million shares authorized; 60,992,156 and

50,698,824 shares issued and outstanding at December 31, 2004 and 2003

 609 507

Additional Paid-in Capital 75,850,810 22,249,321

Retained Earnings 24,059,364 5,177,622

**Total Stockholders’ Equity** 99,910,783 27,427,450

**Total Liabilities and Stockholders’ Equity** $ 109,452,578 $ 31,444,690

TASER INTERNATIONAL, INC.

STATEMENTS OF CASH FLOWS

For the Year Ended December 31, 2004 2003

Cash Flows from Operating Activities:

Net income $ 18,881,742 $ 4,453,690

Adjustments to reconcile net income to net cash

provided by operating activities:

Loss on disposal of assets — 15,873

Depreciation and amortization 551,793 393,568

Provision for doubtful accounts 90,000 12,908

Provision for warranty 361,058 302,165

Compensatory stock options 625,714 177,142

Deferred income taxes 727,892 (369,627)

Stock option tax benefit 11,321,554 3,315,339

Change in assets and liabilities:

Accounts receivable (3,145,779) (4,529,099)

Inventory (3,714,077) (791,165)

Prepaids and other assets (1,102,919) (423,066)

Income tax receivable 239,348 (217,369)

Accounts payable and accrued liabilities 5,551,491 1,853,114

Customer deposits (83,637) 171,074

Net cash provided by operating activities 30,304,180 4,366,546

Cash Flows from Investing Activities:

Purchases of investments (35,273,292) —

Purchases of property and equipment (11,322,299) (3,651,110)

Purchases of intangible assets (195,397) (565,110)

Net cash used in investing activities (46,790,988) (4,216,220)

Cash Flows from Financing Activities:

Payments under capital leases (14,236) (34,026)

Payments on notes payable (250,000) (250,000)

Payments on revolving line of credit — (385,000)

Proceeds from warrants exercised 2,545,065 11,000,519

Proceeds from options exercised 13,084,812 1,819,570

Net cash provided by financing activities 15,365,641 12,151,063

Net (Decrease) Increase In Cash and

Cash Equivalents (1,121,167) 12,301,389

Cash and Cash Equivalents, beginning

of period 15,878,326 3,576,937

Cash and Cash Equivalents, end of period $ 14,757,159 $ 15,878,326

Supplemental Disclosure:

Cash paid for interest $ 1,364 $ 9,922

Cash (refunded) paid for income

taxes—net $ (264,026) $ 202,410

Non Cash Transactions

Increase to deferred tax asset related to tax benefits realized from the exercise of stock options

(with a related increase to additional paid in capital of $37,346,000 and 3,961,928)

 $ 26,024,446 $ 646,589

Note Payable issued for purchase of intangible assets $ — $ 500,000

The accompanying notes are an integral part of these financial statements.

\*Due to the 2004 restatement,Taser International filed this statement with the SEC, but these two numbers were restated from the 2003 Annual Report.As a result the column for 2003 does not add correctly. For mathematical purposes it is suggested that the numbers originally filed in 2003 be used, which are as follows: Deferred income taxes, (1,014,217) and Stock option tax benefit 3,961,928.

**Results of Operations**

Sales and marketing expenses were also reduced by 31%, to 11% of sales for 2004 compared to 16% for 2003 due to better leverage of the fixed expenses. In total, the Company spent $7.2 million in promoting new sales and servicing existing customers in 2004, compared to $3.8 million for 2003. The most significant increases were in the areas of public relations activities, law enforcement training programs, and travel and salaries expenses. The increase in public relations activities is associated with the Company’s continuing efforts to educate the public in

regard to the safety and efficacy of its products. In addition, the training programs presented cost the Company $1.1 million for 2004 compared to $482,000 for 2003.

Concentration of Credit Risk and Major Customers Financial instruments that potentially subject the Company to concentrations of credit risk consist of accounts receivable.

Sales are typically made on credit and the Company generally does not require collateral.

The Company performs ongoing credit evaluations of its customers’ financial condition and maintains an allowance for estimated potential losses. Accounts receivable are presented net of an allowance for doubtful accounts. The allowance for bad debts totaled $120,000 and $30,000 as of December 31, 2004 and 2003, respectively.

The Company sells primarily through a network of unaffiliated distributors. The

Company also reserves the right to sell directly to the end user to secure its credit

interests. In 2004, the Company had three distributors that met or exceeded 10% of total

sales; one of which represented 14% of sales, and two of which individually represented

10% of sales. No other customer exceeded 10% of product sales in 2004. Sales to one

U.S. customer represented 15% of total product sales for 2003. No other customer

exceeded 10% of total product sales in 2003.

At December 31, 2004, the Company had receivables from two customers comprising of

21% and 16% of the aggregate accounts receivable balance. These customers are unaffiliated distributors of the Company’s products. At December 31, 2003, the Company had a receivable from one customer comprising 19% of the aggregate accounts receivable balance. This customer was one of the ten largest U.S. police forces. The Company currently purchases finished circuit boards and injection-molded plastic components from suppliers located in the Phoenix area. Although the Company currently obtains these components from single source suppliers, the Company owns the injection molded component tooling used in their production. As a result, the Company believes it could obtain alternative suppliers in most cases without

incurring significant production delays. The Company also purchases small, machined parts from a vendor in Taiwan, custom cartridge assemblies from a proprietary vendor in Arizona, and electronic components from a variety of foreign and domestic distributors. The Company believes that there are readily available alternative suppliers in most cases who can consistently meet our needs for these components. The Company acquires most of its components on a purchase order basis and does not have long-term contracts with suppliers.

3. Property and Equipment

Property and equipment consist of the following at December 31, 2004 and 2003:

Estimated Useful Life 2004 2003

Leasehold Improvements Lease Term $ 90,658 $ 56,198

Land 2,899,962 2,899,962

Building/Construction in Progress 8,689,046 131,980

Production Equipment 5 Years 1,555,988 1,159,886

Telephone Equipment 5 Years 35,555 35,555

Computer Equipment 3–5 Years 2,501,928 812,869

Furniture and Office Equipment 5–7 Years 834,728 189,117

Total Cost 16,607,865 5,285,567

Less: Accumulated Depreciation 1,851,353 1,338,686

Net Property and Equipment $ 14,756,512 $ 3,946,881

Depreciation expense for the years ended December 31, 2004 and 2003 was $512,668

and $363,899, respectively.

b. Purchase Commitments

The Company has approximately $3,344,000 remaining on the contract to construct its new manufacturing and headquarters facility. The amount due is expected to be paid

during 2005.

c. Litigation

Securities Litigation On January 10, 2005, a securities class action lawsuit was filed in the United States District Court for the District of Arizona against the Company and certain of its

officers and directors, captioned Malasky v. TASER International,Inc.,et al.,Case No.2:05 CV

115. Since then, numerous other securities class action lawsuits were filed against the Company

and certain of its officers and directors. The majority of these lawsuits were filed in the District

ofArizona.

5. Commitments and Contingencies

a. Operating Leases

The Company has entered into operating leases for office space and equipment. Rent expense under these leases for the years ended December 31, 2004 and 2003, was $339,524 and $162,743, respectively.

Future Minimum lease payments under operating leases as of December 31, 2004, are

as follows for the years ending December 31:

2005 $ 197,400

2006 19,788

2007 4,113

2008 —

2009 —

Thereafter —

$ 221,301

Shareholder Derivative Litigation

On January 11, 2005, a shareholder derivative lawsuit was filed in the United States District

Court for the District of Arizona purportedly on behalf of the Company and against certain

of its officers and directors, captioned Goldfine v. Culver, et al., Case No. 2:05 CV 123. Since then, five other shareholder derivative lawsuits were filed in the District of Arizona, two shareholder derivative lawsuits were filed in the Arizona Superior Court, Maricopa County, and one shareholder derivative lawsuit was filed in the Delaware Chancery Court. On February 9,

2005, the shareholder derivative actions pending in federal court were consolidated into a single action under the caption, In re TASER International Shareholder Derivative

Litigation, Case No. 2:05 CV 123. Pursuant to the consolidating order, defendants will not

respond to any of the complaints originally in these actions. Instead, defendants will respond to plaintiffs’ consolidated amended complaint. Defendants have not responded to the cases filed in the Arizona Superior Court or in Delaware Chancery Court. The complaints in the shareholder

derivative lawsuits generally allege that the defendants breached the fiduciary duties owed to the Company and its shareholders by reason of their positions as officers and/or directors of the Company. The complaints claim that such duties were breached by defendants’ disclosure of allegedly false or misleading statements about the safety and effectiveness of Company products and the Company’s financial prospects. The complaints also claim that fiduciary duties

were breached by defendants’ alleged use of non-public information regarding the safety of Company products and the Company’s financial condition and future business prospects for personal gain through the sale of the Company’s stock. The Company is named solely as a nominal defendant against which no recovery is sought. Securities and Exchange Commission

Informal Inquiry The Securities and Exchange Commission has initiated an informal inquiry into Taser with respect to the basis for the Company’s public statements concerning the safety and

performance of the Company’s products, disclosure issues and the accounting for certain

transactions.The inquiry is ongoing. Product Liability Litigation From April 2003 to March 2005, the Company was named as a defendant in 18 lawsuits in which the plaintiffs alleged either

wrongful death or personal injury in situations in which the TASER device was used by law enforcement officers or during training exercises. One case has been dismissed with prejudice, another case has been dismissed without prejudice and the balance of the cases are pending. We have submitted the defense of each of these lawsuits to our insurance carriers as we maintained during these periods and continue to maintain product liability insurance coverage with varying limits and deductibles. The Company’s product liability insurance coverage during these periods ranged from $5,000,000 to $10,000,000 in coverage limits and from $10,000 to $250,000 in deductibles. The Company is defending each of these lawsuits vigorously.

11. Restatement In April 2005, subsequent to the issuance of our financial statements for the year ended December 31, 2004, we discovered an error in that certain stock option grants were

treated as incentive stock options when the grants should have been classified as non-statutory stock options because of the annual limitation on incentive stock options under applicable tax regulations. For employees who exercised stock option grants and held the underlying stock, to the extent such option grants should have been classified as non-statutory stock options (as

opposed to incentive stock options), the employee’s taxable compensation was understated and we were entitled to a deduction from our taxable income equal to the amount of additional compensation attributable to the exercise of non-statutory stock options. This resulted in an increase in our previously reported deferred tax assets at December 31, 2004 by approximately $3.0 million, with a corresponding increase to our additional paid in capital. In addition, while incentive stock options are not subject to payroll tax withholding, non-statutory stock options that result in ordinary income when exercised are subject to payroll tax withholding for the employee and an equal amount to be paid by the employer. The impact to us in the year ended December 31, 2004 of the additional payroll tax withholding was approximately $395,000,

which was recorded as an increase to our selling, general and administrative expenses over amounts previously reported. As a result, our provision for income tax decreased by approximately $152,000, which resulted in a corresponding increase in our deferred tax assets. This adjustment impacted our previously reported net income for the year ended December 31,

2004 by approximately $243,000 which reduced our diluted earnings per share for such period by $0.01 to $0.30.The change in net income was not significant enough to affect basic earnings per share for the year ended December 31, 2004.

Closing Stock Price (adjusted for stock splits)

12-31-04 $31.65

12-31-03 $ 6.86