

AeroVironment Inc  
Form 10-K  
June 25, 2010

Table of Contents

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**Annual Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the fiscal year ended April 30, 2010**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-33261**

**AEROVIRONMENT, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**95-2705790**

(I.R.S. Employer Identification No.)

**181 W. Huntington Drive, Suite 202  
Monrovia, CA**

(Address of Principal Executive Offices)

**91016**

(Zip Code)

Registrant's telephone number, including area code: **(626) 357-9983**

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of Class  
Common Stock, par value \$0.0001 per share**

**Name of each exchange on which registered  
The NASDAQ Stock Market LLC**

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

## Edgar Filing: AeroVironment Inc - Form 10-K

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting stock held by non-affiliates of the registrant, based on the closing price on the NASDAQ Global Select Market on October 31, 2009 was approximately \$458.6 million.

As of June 11, 2010, the issuer had 21,753,413 shares of common stock, par value \$0.0001 per share, issued and outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the conclusion of the registrant's fiscal year ended April 30, 2010, are incorporated by reference into Part III of this Form 10-K.

---

Table of Contents

**AEROVIRONMENT, INC.  
INDEX TO FORM 10-K**

	<b>Page</b>
<b><u>PART I</u></b>	
<u>Item 1. Business</u>	<u>2</u>
<u>Item 1A. Risk Factors</u>	<u>21</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>40</u>
<u>Item 2. Properties</u>	<u>40</u>
<u>Item 3. Legal Proceedings</u>	<u>40</u>
<u>Item 4. (Removed and Reserved)</u>	<u>40</u>
<b><u>PART II</u></b>	
<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>41</u>
<u>Item 6. Selected Consolidated Financial Data</u>	<u>43</u>
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>43</u>
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>53</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>54</u>
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>81</u>
<u>Item 9A. Controls and Procedures</u>	<u>81</u>
<u>Item 9B. Other Information</u>	<u>82</u>
<b><u>PART III</u></b>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>84</u>
<u>Item 11. Executive Compensation</u>	<u>84</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>84</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>84</u>
<u>Item 14. Principal Accounting Fees and Services</u>	<u>84</u>
<b><u>PART IV</u></b>	
<u>Item 15. Exhibits, Financial Statement Schedules</u>	<u>85</u>



Table of Contents

**PART I**

**Forward-Looking Statements**

This Annual Report on Form 10-K, or Annual Report, contains forward-looking statements, which reflect our current views about future events and financial results. We have made these statements in reliance on the safe harbor created by the Private Securities Litigation Reform Act of 1995 (set forth in Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act). Forward-looking statements include our views on future financial results, financing sources, product development, capital requirements, market growth and the like, and are generally identified by terms such as "may," "will," "should," "could," "targets," "projects," "predicts," "contemplates," "anticipates," "believes," "estimates," "expects," "intends," "plans" and similar words. Forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors which could cause the actual results to differ materially from the forward-looking statement. These uncertainties and other factors include, among other things:

unexpected technical and marketing difficulties inherent in major research and product development efforts;

availability of U.S. government funding for defense procurement and research and development programs;

the extensive regulatory requirements governing our contracts with the U.S. government and the results of any audit or investigation of our compliance therewith;

the potential need for changes in our long-term strategy in response to future developments;

unexpected changes in significant operating expenses, including components and raw materials;

changes in the supply, demand and/or prices for our products;

increased competition, including from firms that have substantially greater resources than we have;

changes in the regulatory environment; and

general economic and business conditions in the U.S. and elsewhere in the world.

Set forth below in Item 1A, "Risk Factors" are additional significant uncertainties and other factors affecting forward-looking statements. The reader should understand that the uncertainties and other factors identified in this Annual Report are not a comprehensive list of all the uncertainties and other factors that may affect forward-looking statements. We do not undertake any obligation to update or revise any forward-looking statements or the list of uncertainties and other factors that could affect those statements.

**Item 1. Business.**

**Overview**

We design, develop, produce and support a technologically-advanced portfolio of unmanned aircraft systems, or UAS, that we supply primarily to organizations within the U.S. Department of Defense, or DoD, charging systems for electric vehicle batteries and power cycling and test systems that we supply to commercial and government customers. We derive the majority of our revenue from these business areas and we believe that the markets for these solutions have significant growth potential. Additionally, we believe that some of the innovative potential

## Edgar Filing: AeroVironment Inc - Form 10-K

products in our research and development pipeline, some of which we receive customer funding to develop, others we fund ourselves, will emerge as new growth platforms in the future, creating additional market opportunities.

Table of Contents

The success we have achieved with our current products stems from our investment in research and development and our ability to invent and deliver advanced solutions, utilizing our proprietary technologies, to help our government and commercial customers operate more effectively and efficiently. Our core technological capabilities, developed through nearly 40 years of innovation, include lightweight aerostructures, electric propulsion systems, efficient electric energy generation and storage systems, high-density energy packaging, miniaturization, controls integration and systems engineering optimization.

Our Unmanned Aircraft Systems business segment focuses primarily on the design, development, production and support of innovative UAS that provide situational awareness and other mission effects to increase the security and effectiveness of our customers' operations. Our Efficient Energy Systems business segment focuses primarily on the design, development, production and support of innovative efficient electric energy systems that address the growing demand for clean transportation.

**Our Strategy**

As a technology company, our strategy is to develop innovative new solutions that enable us to enter large markets, gain market share, and grow as market adoption increases. We believe that by introducing new solutions that provide customers with compelling value we have been able to enter markets that would otherwise have only been available to large, entrenched competitors. Our goal is to achieve market adoption of new solutions leading to complete product lines with their own product lifecycles.

We intend to grow our business by maintaining leadership in the markets for UAS, electric vehicle charging systems and power cycling and test systems and by creating new solutions that enable us to enter and lead new markets. Key components of this strategy include the following:

***Expand our current solutions to existing and new customers.*** Our small UAS, electric vehicle charging systems and power cycling and test systems are leading solutions in their respective North American markets. We intend to increase the penetration of our small UAS products within the U.S. military, the military forces of allied nations and non-military U.S. customers. We believe that the increased use of our small UAS in the U.S. military will be a catalyst for increased demand by allied countries, and that our efforts to pursue new applications will help to create non-military opportunities. We similarly intend to increase the penetration of our electric vehicle charging systems and power cycling and test systems into existing and new customers in North America and globally.

***Deliver innovative new solutions.*** Innovation is the primary driver of our growth. We plan to continue research and development efforts to develop better, more capable products, services and business models, both in response to and in anticipation of customer needs. In some cases these innovations manifest themselves as upgrades to existing offerings, expanding our footprint among existing customers and markets. In other cases these innovations become entirely new solutions that represent potential new markets, customers and business opportunities. We believe that by continuing to invest in research and development we will continue to deliver innovative, new products and services that address market needs within and outside of our current target markets, enabling us to create new opportunities for growth.

***Foster our entrepreneurial culture and continue to attract, develop and retain highly-skilled personnel.*** We have created a corporate culture that encourages innovation and an entrepreneurial spirit, which helps to attract and retain highly-skilled professionals. We intend to nurture this culture to encourage the development of the innovative, highly technical solutions that give us our competitive advantage. A core component of our culture is the demonstration of trust and integrity in all of our interactions, contributing to a positive work environment and engendering loyalty among our customers.

Table of Contents

**Preserve our agility and flexibility.** We are able to respond rapidly to evolving markets and deliver new products and system capabilities quickly, efficiently and affordably. We believe that this ability helps us to strengthen our relationships with customers. We intend to maintain our agility and flexibility, which we believe to be important sources of differentiation when we compete against competitors with more extensive resources.

**Our Customers**

We sell the majority of our small UAS and UAS services to organizations within the DoD. Our Efficient Energy Systems business segment generates revenue from commercial and, to a lesser extent, government customers.

During our fiscal year ended April 30, 2010, approximately 44% of our sales were made to the U.S. Army pursuant to orders made under contract by the U.S. Army on behalf of itself as well as several other services of the DoD. Other U.S. government agencies and government subcontractors accounted for 42% of our sales revenue, while purchases by foreign and commercial customers accounted for the remaining 14% of sales revenue during our fiscal year ended April 30, 2010.

**Industry Background**

**Small UAS**

The market for our small UAS has grown significantly over the last several years due to the U.S. military's post-Cold War transformation and the demands associated with the current global threat environment. Following the end of the Cold War, the U.S. military began its transformation into a smaller, more agile force that operates via a network of observation, communication and precision targeting technologies. This transformation accelerated following the terrorist attacks of September 11, 2001, as the U.S. military required improved, distributed observation and targeting of combat enemies who operate in small groups, often embedded in dense population centers or dispersed in remote locations. We believe that UAS, which range from large systems, such as Northrop Grumman's Global Hawk and General Atomics' Predator, Sky Warrior and Reaper, to small systems, such as our Raven, Wasp and Puma, are an integral component of this transforming military force because they provide critical observation and communications capabilities serving the increasing demand for actionable intelligence, while reducing risk to individual "warfighters." Our small UAS can provide real-time observation and communication capabilities to the small units who directly control them. As we explore opportunities to develop new markets for our small UAS, such as border surveillance, law enforcement and petrochemical industry infrastructure monitoring, we expect further growth through the introduction of UAS technology to non-military applications once rules are established for their safe and effective operation in the national airspace.

**Stratospheric Persistent UAS**

We believe a market opportunity exists for UAS that can fly for multiple days to perform continuous remote sensing and communications relay missions in an affordable manner. The emergence of distributed military threats in geographic areas with limited communications infrastructure has prompted U.S. military forces to deploy solutions to manage the increasing volume of data generated by their operations in those areas. Existing solutions such as communications satellites, manned aircraft and unmanned aircraft address some of this emerging demand for bandwidth, but do so at relatively high financial and resource costs. Given the nature of asymmetrical warfare, with embedded military adversaries who operate in population centers, rural areas and remote locations, the ability to observe areas of interest on a continuous basis with high resolution sensors remains a critical and largely unmet need. Geosynchronous satellites provide fixed, continuous communications relay capabilities to much of the globe, but they operate nearly 25,000 miles from the surface of the earth, therefore limiting bandwidth and requiring relatively larger, higher power ground stations. Observation satellites typically



Table of Contents

operate at lower altitudes, but are unable to maintain geosynchronous positions, meaning they are moving with respect to the surface of the earth, resulting in limited coverage over specific areas of interest, and significant periods of time during which they do not cover those areas. An unmanned aircraft system that is capable of operating for extended periods of time over an area of interest without coverage gaps while carrying a communications relay or observation payload in an affordable manner could help to address this need.

**Loitering Airborne Munitions Systems**

The age-old pursuit of weapons capable of striking their targets with high precision while minimizing the risk to surrounding civilians, property and the user has been furthered in recent years by advances in enabling technologies. Weapons such as laser-guided missiles, "smart" bombs and GPS-guided artillery shells have dramatically improved the accuracy of attacks against hostile targets. Most of these weapons systems typically are operated by elements of the armed forces that are geographically removed from the target area, requiring advanced planning and coordination to enable their use. When ground forces find themselves engaged in a firefight or near a target, their ability to deploy and use a precision weapon system quickly and easily can mean the difference between mission success and failure. Embedding a lethal payload into a man-portable unmanned aircraft system could provide warfighters with a valuable alternative to existing airborne munitions systems.

**Electric Vehicle Charging Systems**

Electric and hybrid electric vehicles require on-board battery packs to provide the energy that powers their operation. These battery packs range in size, weight and energy content. As drivers operate electric vehicles, their battery packs discharge energy similar to the way an internal combustion vehicle consumes gasoline as it is driven. In order to continue operating, the driver of an electric vehicle must either replace the depleted battery pack with a fully charged pack or recharge the pack while it remains in the vehicle. Because of the differences in battery size and composition, as well as the operational requirements associated with each vehicle, there exist a variety of charging systems designed to support the operation of these vehicles. These charging systems range from relatively slow charging devices that require many hours to completely recharge a battery pack, to extremely fast chargers that can do so in a very short amount of time.

*Industrial Electric Vehicle Charging Systems*

In industrial applications, fast charge technology, which charges a battery with a high electrical current while the battery remains in the vehicle, eliminates the need for frequent battery changing and a dedicated battery room. This approach increases productivity, reduces operating costs and improves facility safety. The earliest adopters of fast charge technology include the automotive and air transportation industries. Large food and retail industry customers are now also utilizing fast charge technology.

Electric industrial vehicles are powered by large onboard batteries that can consume up to 17 cubic feet and weigh up to 3,500 pounds. In multi-shift fleet operations, traditional charging systems require users to exchange vehicle batteries throughout the day because these batteries discharge their energy through vehicle usage and there is insufficient vehicle downtime to recharge them during a shift. As a result, drivers must leave their work area when the battery reaches a low state of charge and drive to a dedicated battery changing room, which often occupies valuable floor space and is frequently located far from a driver's work area. The driver or in some cases a dedicated battery attendant must then remove the battery from the vehicle, place it on a storage rack, connect it to a conventional battery charger, identify a fully-charged battery, move it into the vehicle's battery compartment and reconnect the battery to the motor before the driver may return to the work area. These battery changes take place every day in thousands of facilities around the world, resulting in reduced material movement and

Table of Contents

increased operating costs. Furthermore, depending on the type of battery, conventional battery chargers can require up to eight hours to recharge the battery, which then must cool for up to an additional eight hours before it is ready to be used again. Consequently, depending on vehicle usage and the number of shifts in an operation, a fleet may require more than one battery per vehicle, which necessitates additional storage space, chargers and maintenance time. Moreover, the high levels of heat generated by conventional battery chargers during their normal use can cause excessive evaporation of the water contained in the battery and damage to the battery's components. Over time, this evaporation of fluid and damage to components result in battery degradation and negatively affect the battery's life.

*Passenger and Fleet Electric Vehicle Charging Systems*

A number of factors contribute to a growing appetite on the part of consumers, governments and automakers for vehicles that do not rely on fossil fuels. These factors include:

concerns regarding the environmental impact of resource extraction and carbon emissions associated with fossil fuel-based transportation;

growing awareness of the geopolitical and economic costs associated with the current dependence on petroleum imports;

increasing government funding to support "clean tech" technologies;

anticipation of future energy price volatility; and

the increasing demand for automobiles in large, rapidly growing markets such as China and India and the resulting growing demand for fossil fuels.

In response to these factors numerous automotive manufacturers around the world are developing and planning to introduce modern plug-in electric and hybrid vehicles for everyday consumer and fleet transportation. Vehicles in this class will incorporate battery electric drive systems either in a dedicated format in which an onboard battery pack supplies electricity to an electric motor, or in an advanced hybrid format in which an onboard battery pack provides electricity to an electric motor, and a small onboard internal combustion engine recharges the battery as needed. An all-battery electric vehicle, or BEV, requires that its battery pack be recharged from an external power source or be replaced with a fully charged battery pack. An advanced hybrid vehicle requires that it be charged from an external power source to minimize gasoline consumption and vehicle carbon emissions.

Most electric vehicles will likely be recharged using external systems installed at home, work and at public places such as shopping centers, supermarkets and locations similar to gasoline stations. Battery swapping is not considered to be a practical solution for widespread BEV use given its cost, complexity, physical wear and tear on the battery pack and the requirement for standardization of battery pack design and vehicle configuration to enable it. With a number of new consumer electric vehicle models scheduled to enter the market beginning in late 2010 there exists a need for the implementation of charging infrastructure to enable their safe, reliable and practical recharging.

The rate at which a device can recharge a battery pack depends on the amount of power available, the size of the battery pack, the battery pack's ability to receive a charge, the existence of an onboard controller and the device's capacity for transferring electricity from the electric grid to the battery pack. Electric vehicle charging systems are segmented into three general categories: Level 1 systems are power cords that plug into a standard 110 volt AC outlet and provide a very slow recharge that could require up to 24 hours for certain batteries; Level 2 systems require installation into a 220 volt AC circuit and are capable of fully recharging certain battery packs overnight; and DC systems typically require installation into a 440 volt AC circuit and are capable of fully recharging battery packs designed to accept such a charge in minutes. We believe that broad adoption of electric vehicles will require a mix of these types of charging systems, distributed so as to make them accessible to drivers when and where they need them.

Table of Contents

**Power Cycling and Test Systems**

Developers and manufacturers of plug-in electric and hybrid vehicles typically conduct a variety of tests on the electric propulsion and storage systems that form the core of their vehicles. These tests include simulating the consumption, conversion and storage of electricity through a range of operating scenarios, and include long term testing to simulate the rigors of real-world driving. Developers of battery packs, electric motors and fuel cells also test their devices to validate design hypotheses and identify potential operating issues. Global interest in alternative energy transportation solutions, including plug-in electric and hybrid vehicles, has increased and has served as a driver of increased demand for electric vehicle and component test systems. This demand spans commercial, government, military and university research and development labs as well as commercial manufacturing facilities as more funding and attention are focused on clean transportation.

**Our Solutions**

**UAS Products**

Our small UAS, including Raven, Wasp, and Puma, are designed to provide valuable Intelligence, Surveillance and Reconnaissance, or ISR, including real-time tactical reconnaissance, tracking, combat assessment and geographic data, directly to the small tactical unit or individual warfighter, thereby increasing flexibility in mission planning and execution. Our small unmanned aircraft wirelessly transmit critical live video and other information generated by their payload of electro-optical or infrared sensors directly to a hand-held ground control system, enabling the operator to view and capture images, during the day or at night, on a hand-held ground control unit. Our ground control systems allow the operator to control the aircraft by programming it for GPS-based autonomous navigation using operator-designated way-points and also provide for manual flight operation. These ground control systems are designed for durability and ease of use in harsh environments and incorporate a user-friendly, intuitive, graphical user interface. All of our production small unmanned aircraft operate from our common ground control unit.

All of our small UAS are designed to be man-portable, assembled without tools in less than five minutes and launched and operated by one person, with limited training required. The efficient and reliable electric motors used in all of our small UAS are powered by replaceable modular battery packs that can be changed in seconds, enabling rapid return to flight. All of our small UAS can be recovered through an autonomous landing feature that enables a controlled descent to a designated location.

In military applications, our systems enable tactical leaders to observe the next corner, intersection or ridgeline in real-time. This information facilitates faster, safer movement through urban and mountainous environments and can enable troops to be proactive based on field intelligence rather than being forced to react to an attack. Moreover, by providing this information, our small UAS reduce the risk to warfighters and to the surrounding population by providing the ability to tailor the military response to the threat. U.S. military personnel regularly use our small UAS, such as Raven, for force protection, combat observation and damage assessment missions. These reusable systems are easy to transport, assemble and operate and are relatively quiet when flying at typical operational altitudes of 200 to 300 feet, the result of our efficient electric propulsion systems. Furthermore, their small size makes them difficult to see from the ground. In addition, the low cost of our small UAS relative to larger systems and alternatives makes it practical for customers to deploy these assets directly to warfighters.

Our small UAS also include spare equipment, alternative payload modules, batteries, chargers, repair services and customer support. We provide training by our highly-skilled instructors, who typically have extensive military experience, and continuous refurbishment and repair services for our products. By maintaining close contact with our customers and users in the field, we gather critical feedback on our products and incorporate that information into ongoing product development and

Table of Contents

research and development efforts. This approach enables us to improve our solutions in response to, and in anticipation of, evolving customer needs.

Each system in our small UAS portfolio typically includes three aircraft, our common and interoperable hand-held ground control unit and an array of spare parts and accessories. Our current small UAS portfolio consists of the following aircraft:

Small UAS Product	Wingspan (ft.)	Weight (lbs.)	Recovery	Standard Sensors	Range (mi.)(1)	Flight Time (min.)(1)
<b>Raven</b>	4.5	4.2	Vertical autonomous landing capable	Electro-optical or infrared	6.0	90
<b>Wasp</b>	2.4	1.0	Horizontal autonomous landing capable	Electro-optical and infrared	3.0	45
<b>Puma</b>	9.2	13	Vertical autonomous landing capable (ground or water)	Mechanical pan, tilt, zoom electro-optical and infrared	9.0	120

(1) Represents minimum customer-mandated specifications for all operating conditions. In optimal conditions, the performance of our products may significantly exceed these specifications.

The ground control system, or GCS, is the primary interface between the operator and the aircraft, and allows the operator to control the direction, speed and altitude of the aircraft as well as view the visual information generated by the aircraft through real-time, streaming video. Our single GCS interfaces with each of our air vehicles, providing a common user interface with each of our air vehicles. In addition to the thousands of air vehicles delivered to our customers, thousands of GCS are also in our customers' hands.

During fiscal 2010 we began production of new Raven systems incorporating our digital data link, DDL, and retrofit kits to convert customers' analog Raven systems to digital communications format. The result of a successful development program, DDL enhances the capabilities, and ultimately, the utility of our small UAS by enabling more efficient radio spectrum utilization and communications security. Small UAS incorporating our DDL offer many more channels as compared to our analog link, increasing the number of air vehicles that can be operated in a given area. Additionally, our DDL enables each air vehicle to operate as an IP, or Internet-Protocol, addressable hub capable of routing and relaying data to and from multiple other nodes on this *ad hoc* network. This capability will enable beyond line-of-sight operation of our small UAS, further enhancing their value proposition to our customers.

**UAS Services**

In support of our small UAS we offer a suite of services that help to ensure the successful operation of our products by our customers. We provide spare parts as well as repair, refurbishment and replacement services through our services operation. We designed our services operation to minimize supply chain delays and provide our customers with spare parts, replacement aircraft and support whenever and wherever they need them. We developed an Internet-accessible logistics system to provide our customers with the status of their returned products and their inventory that we help manage. This secure system also provides recent parts and repairs history and tracks usage data to enable inventory optimization forecasting. Our Simi Valley, California facility, also serves as the primary depot for repairs and spare parts.

Table of Contents

We provide complete training services to support all of our small UAS. Our highly-skilled instructors typically have extensive military experience. We deploy training teams throughout the continental United States and abroad to support our customers' wide variety of training needs on both production and development-stage systems. We also offer turnkey flight operation services to customers requiring the information generated by our small UAS.

We provide contract engineering services in support of customer-funded research and development projects. These types of projects typically involve developing new solutions and improvements to existing solutions that we introduce as retrofits or upgrades

The U.S. Army projects its total demand for our Raven small UAS at approximately 2,182 new systems, of which we had delivered approximately 70% as of April 30, 2010. For the fiscal years ended April 30, 2010, 2009 and 2008, our UAS segment products and services accounted for 90%, 85% and 86%, respectively, of our revenue.

**Efficient Energy Systems Products**

Our Efficient Energy Systems business segment produces industrial productivity and clean transportation solutions for commercial and government customers, develops new potential clean transportation solutions, and performs contract engineering services. These solutions consist of PosiCharge electric vehicle charging systems for industrial electric material handling fleets, electric vehicle charging systems for passenger and fleet vehicles, and power cycling and test systems for developers and manufacturers of plug-in electric and advanced hybrid vehicles as well as battery packs, electric motors and fuel cells. For the fiscal years ended April 30, 2010, 2009 and 2008, Efficient Energy Systems sales accounted for 10%, 15% and 14%, respectively, of our revenue. We believe that the markets for our electric vehicle charging systems and power cycling and test systems continue to develop and that continued diversification of our customer base will support increased penetration into target markets.

**Industrial Electric Vehicle Charging Systems**

Developed from our work on electric and hybrid electric vehicles and advanced battery systems in the 1990s, PosiCharge electric vehicle charging systems quickly and safely recharge industrial vehicle batteries while the batteries remain in the vehicle during regularly scheduled breaks and other times when the vehicle is not in use, thereby maintaining a sufficient level of energy throughout the workday. By eliminating battery changing, PosiCharge systems improve supply chain productivity by returning time to the vehicle operator to complete more work. Furthermore, because of their advanced efficient energy capabilities, PosiCharge systems can reduce the amount of electricity required to support electric industrial vehicles by several hundred dollars per year per vehicle as compared to conventional battery chargers. Many customers who implement our fast charge systems in their facilities are able to re-purpose the battery changing room floor space for more productive activities and create a safer working environment, as drivers or battery attendants no longer need to exchange large, lead-acid batteries.

The proprietary battery charging algorithms built into PosiCharge systems, which are tailored to battery type, brand and size, maximize the rate at which energy is sent into the battery while minimizing heat generation and its damaging effects. We developed these algorithms over years of advanced battery testing and usage. We believe our work to develop these algorithms contributed to the major battery manufacturers offering battery warranties for fast charge, which provided a critical assurance to customers that fast charge systems would not harm their batteries. In combination with a weekly equalization charge that balances all the cells within the battery pack, our "intelligent" charging process enhances the performance of batteries and helps them to achieve improved operation. We believe that competitive fast charge and conventional charge systems, which lack our current and voltage regulating tailored charge algorithms and monitoring capabilities, may actually contribute to lower battery performance and lifespan, ultimately resulting in higher battery costs and degraded vehicle performance.

Table of Contents

We project that PosiCharge system customers typically begin to realize cost savings when compared to battery changing within the first twelve months of operation. Operators of large fleets of electric industrial vehicles who use PosiCharge systems in multiple settings, including factories, distribution centers, cold storage facilities and airport tarmacs, include Ford Motor Company, SYSCO Corporation, Southwest Airlines and IKEA.

Our PosiCharge systems and support products range from lower-power devices for smaller, less heavily-used vehicles to high-power devices for large, heavy-duty vehicles, and are capable of charging from one to 16 vehicles concurrently, depending on the needs of the operation. Included in our product line are systems for indoor and outdoor use, such as for airport ground support equipment. We also supply accessories to help our customers integrate PosiCharge systems into their operations. These accessories include automated battery watering systems, charge status indicator lights, battery-mounted fans and cable management options.

**Power Cycling and Test Systems**

We supply a line of power cycling and test systems to research and development organizations that focus on developing electric propulsion systems, electric generation systems and electricity storage systems. Customers employ these electric load and sink systems to test batteries, electric motors and fuel cell systems.

Our line of DC test systems has the flexibility to perform a variety of supplier load tests. With a full power range (+/-5kW to +/-800kW) of bi-directional DC equipment, our power cycling and test systems can handle virtually any DC supply or load requirement from lead acid to the latest Li-ion batteries to fuel cells with integrated power electronics. In addition, these systems can emulate any drive train component, enabling the testing of individual components or partial drive trains accurately and realistically, allowing true hardware-in-the-loop testing. We also offer flexible software control options - via the C language Remote Operation System or ROS, Windows-based languages such as LabVIEW or CAN.

**Contract Engineering Services**

We actively pursue internally and externally funded projects that help us to strengthen our technological capabilities. We submit bids to large research customers such as the Defense Advanced Research Projects Agency, the U.S. Air Force, the U.S. Army and the U.S. Special Operations Command for projects that we believe have future commercial application. Contract engineering services conducted through our Efficient Energy Systems business segment represent a strategic source of innovation for us, and an increasing portion of our business involves providing advanced battery module and pack testing services to automotive manufacturers in support of their plug-in electric and hybrid vehicle development programs. Providing these services contributes to the development and enhancement of our technical competencies. In an effort to manage the ability of our key technical personnel to support multiple, high-value research and development initiatives, we attempt to limit the volume of contract engineering projects that we accept. This process enables us to focus these personnel on projects we believe offer the greatest current and future value to our business. Consequently, while these projects typically add to our operating margin, we are not seeking to grow this service offering at this time.

**Backlog**

We define funded backlog as unfilled firm orders for products and services for which funding currently is appropriated to us under the contract by the customer. As of April 30, 2010 and April 30, 2009, our funded backlog was approximately \$72.3 million and \$114.8 million, respectively. We expect that 87% of our funded backlog will be filled during our fiscal year ending April 30, 2011.

Table of Contents

In addition to our funded backlog, we had unfunded backlog of \$269.4 and \$510.6 million as of April 30, 2010 and April 30, 2009, respectively. We define unfunded backlog as the total remaining potential order amounts under cost reimbursable and fixed price contracts with multiple one-year options, and indefinite delivery indefinite quantity, or IDIQ contracts. Unfunded backlog does not obligate the U.S. government to purchase goods or services. There can be no assurance that unfunded backlog will result in any orders in any particular period, if at all. Management believes that unfunded backlog does not provide a reliable measure of future estimated revenue under our contracts.

Because of possible future changes in delivery schedules and/or cancellations of orders, backlog at any particular date is not necessarily representative of actual sales to be expected for any succeeding period, and actual sales for the year may not meet or exceed the backlog represented. Our backlog is typically subject to large variations from quarter to quarter as existing contracts expire, or are renewed, or new contracts are awarded. A majority of our contracts, specifically our IDIQ contracts, do not currently obligate the U.S. government to purchase any goods or services. Additionally, all U.S. government contracts included in backlog, whether or not funded, may be terminated at the convenience of the U.S. government.

**Technology, Research and Development**

**Technological Competence and Intellectual Property**

Our company was founded by the late Dr. Paul B. MacCready, the former Chairman of our board of directors and an internationally renowned innovator who was instrumental in establishing our entrepreneurial and creative culture. This culture has enabled us to attract and retain highly-motivated, talented employees and has established our reputation as an innovator.

The innovations of our company and our founder include, among others: the world's first effective human-powered and manned solar-powered airplanes; the first modern consumer electric car (the EV1 prototype for General Motors); the world's highest flying airplane in level flight, Helios, a solar-powered UAS that reached over 96,000 feet in 2001; and, more recently, Global Observer, the world's first liquid hydrogen-powered UAS. The Smithsonian Institution has selected five vehicles developed by us for its permanent collection. Our history of innovation excellence is the result of our creative and skilled employees whom we encourage to innovate and develop new technologies.

Our primary areas of technological competence, UAS and efficient electric energy, represent the sum of numerous technical skills and capabilities that help to differentiate our approach and product offerings. The following table highlights a number of our key technological capabilities:

<b>UAS Technology</b>	<b>Efficient Electric Energy Technology</b>
Lightweight, low speed aerostructures and propeller design	Battery management and testing
Miniaturized avionics and micro/nano unmanned aircraft systems	Power electronics and controls
Image stabilization and target tracking	Efficient drive systems and controls
Unmanned autonomous control systems	Fuel cell system integration and testing
Payload integration	High-density energy packaging
Hydrogen propulsion systems and high-pressure-ratio turbochargers	Electric power generation, storage and management
Stratospheric flight operations	Charging algorithms and thermal management
Fluid dynamics	On/off grid controls
Miniature, low power wireless digital communications	Controls integration
System integration and optimization	System integration and optimization

Table of Contents

A fundamental part of this process of innovation is a screening process that helps business managers identify commercial opportunities that support current or desired technological capabilities. Similarly, we manage new product and business concepts through a rigorous commercialization process that governs spending, resources, time and intellectual property considerations. An important element of our commercialization process is ensuring that our technology and business development activities are strongly linked to customer needs in attractive growth markets. Throughout the process we revalidate our customer requirement assumptions to ensure that the products and services we ultimately deliver are of high value.

As a result of our commitment to research and development, we possess an extensive portfolio of intellectual property in the form of patents, trade secrets, copyrights and trademarks across a broad range of unmanned aircraft system and advanced energy technologies. As of April 30, 2010, we had 64 U.S. patents issued, 61 U.S. patent applications pending, and numerous foreign patents and applications. In many cases, when appropriate, we opt to protect our intellectual property through trade secrets as opposed to filing for patent protection in order to preserve confidentiality.

The U.S. government has licenses to our patented technology that was specifically developed in performance of government contracts, and it may use or authorize others to use the inventions covered by such patents for government purposes.

While we consider the development and protection of our intellectual property to be integral to the future success of our business, at this time we do not believe that a loss or limitation of rights to our intellectual property would have a material adverse effect on our business taken as a whole.

**Research, Development and Commercialization Projects**

One important aspect of our technology research and development activity is the development and commercialization of innovative solutions that we believe can become new products and open opportunities for us to enter large new markets or accelerate the growth of our current products. We invest in an active pipeline of these commercialization projects that range in maturity from technology validation to early market adoption. We cannot predict when, if ever, these projects will be successfully commercialized, or the exact level of capital expenditures they could require, which could be substantial. In our fiscal year 2010, we transitioned our Digital Data Link, a communications capability for our small UAS, from development to production. Four development programs are described below.

**Global Observer.** Global Observer is a high-altitude, long-endurance UAS under development to address the critical need for affordable, 24-hour, 365-days-a-year persistent communications and ISR. The continuation of years of research with both our own and U.S. government development funding, the configuration now being developed under a three-year joint capabilities technology demonstration program, or JCTD, with several agencies of the U.S. government is being designed to operate at up to 65,000 feet for up to a week between landings. We expect the efficiency and endurance (three to four times the longest flight time of existing fixed-wing aerial options) of this UAS to provide for dramatically lower operating and total life cycle costs for missions where persistent communications or surveillance is critical. The Global Observer platform is intended to be the low-cost equivalent of a twelve-mile-high, redeployable satellite, providing a footprint of coverage of up to 600 miles in diameter and capable of providing a broad array of services, including high-speed broadband data, video and voice relay and ISR. We expect these capabilities to provide the foundation for multiple high-value applications including communications relay and ISR missions for defense and homeland security, storm tracking, telecommunications infrastructure, wildfire detection/tracking and disaster recovery services.

**Switchblade.** We are developing a packaged, tube-launched UAS that is designed to deliver different payloads in different sizes and configurations based on mission requirements. One example of this offering is a single-use, hand-held, small UAS with the ability to destroy a target with minimal



Table of Contents

collateral damage through the detonation of an onboard explosive upon impact. This system would be launched by a single individual and operated through the standard ground control unit used to control our other small unmanned air vehicles. This version of Switchblade is being designed to allow the operator to identify a threat using visual information transmitted from the aircraft to the ground control unit, lock-on to the target, and neutralize the target by triggering an autonomous terminal guidance phase which results in the aircraft's impact with the target and simultaneous detonation of the explosive payload. We believe that recent combat experience indicates that such a capability would be of great value and could significantly improve the ability to neutralize hostile elements, such as snipers, machine gunners and mortar launchers. Development of this system under customer funding has achieved desired milestones including demonstrating dynamic target tracking and real-time aircraft course correction and high precision, as well as launching from multiple platforms.

***Stealthy Perch and Persistent Stare UAS.*** We are under contract to develop a small UAS capable of performing "hover/perch and stare" missions. The Stealthy, Persistent, Perch and Stare, or SP2S, UAS was originally based on our small Wasp UAS, a one-pound, 29-inch wingspan battery-powered air vehicle that is being procured and deployed by both the U.S. Air Force and the U.S. Marine Corps. The goal of the SP2S program is to develop the technology to enable an entirely new generation of perch-and-stare micro air vehicles capable of flying to difficult-to-access locations, landing on and securing to a "perch" position, conducting sustained, perch-and-stare surveillance missions, and then re-launching from its perch and returning to its home base.

***Passenger and Fleet Plug-In Electric and Hybrid Vehicle Fast Charging Systems.*** In response to automakers' plans to introduce BEVs and broader trends favoring clean transportation we are developing solutions to support the expected introduction of plug-in electric and hybrid vehicles from nearly every major automaker and many startups worldwide. We believe that most plug-in electric and many plug-in hybrid vehicle users will charge their vehicles overnight at their homes. For those without a charging location at home or who make trips beyond the range of their battery pack, public charging infrastructure will be required. Our strategy is to offer a full solution of charging infrastructure, including overnight home chargers, public chargers, public fast chargers, installation support, systems data collection and communications via multiple wired and wireless data communications options. We intend to offer an integrated solution designed to enable the broad adoption and the practical use of plug-in electric and hybrid vehicles. Our goal is to enable drivers to use these electric vehicles as practical alternatives to gas-powered automobiles: from home charging to "pay at the pump" fast charging in as little as ten minutes.

In January 2010, a major auto manufacturer selected us to support the rollout of a new model plug-in electric vehicle across the U.S. We will provide, install and support a home charging system that will enable the full recharging of the vehicle's battery pack in several hours. We believe this represents a valuable position from which to expand our charging infrastructure footprint in the U.S. and globally. We are working in the U.S. and internationally with automakers, utilities, government agencies at all levels and with private industry to explore business models and to promote our solutions.

Scheduled for commercial rollout in 2010, our plug-in electric and hybrid vehicle fast charge system is expected to be a powerful tool that can help enable the broader adoption of these vehicles in two main categories:

**Passenger Electric Vehicles.** A network of fast charge systems would ensure that plug-in electric vehicle drivers have access to a ten-minute battery charge when and where needed and that advanced hybrid electric vehicle drivers could be able to drive more miles in electric mode, thereby reducing emissions and consuming less gasoline or diesel, which is typically more expensive than electricity.

**Fleet Electric Vehicles.** Fleet plug-in electric and hybrid vehicles could come in multiple vehicle types and duty cycles, from inner-city taxis and buses to medium

Table of Contents

range delivery vans and utility repair vehicles. A few fast charge systems installed in a maintenance yard or a family of systems in the city could help fleet operators maintain throughput while reducing emissions and fuel expenses.

For the fiscal years ended April 30, 2010, 2009 and 2008, our internal research and development spending amounted to 10%, 9% and 8%, respectively, of our revenue, and customer-funded research and development spending amounted to an additional 32%, 27% and 13%, respectively, of our revenue.

**Sales and Marketing**

Our marketing strategy is to increase awareness of our brand among key target market segments and to associate AeroVironment with innovation, flexibility, agility and the ability to deliver reliable new technology solutions that improve operational effectiveness and efficiency. Our reputation for innovation is a key component of our brand and has been acknowledged through a variety of awards and recognized in numerous articles in domestic and international publications. We have registered the trademarks for AeroVironment, PosiCharge, Global Observer, and Raven and have submitted several other applications for trademark registration, including those for the AV logo, EV Solutions™, GO™, and Switchblade™.

**Small UAS**

We organize our U.S. small UAS business development team members by customer and product and have team members located where they are in close proximity to the customers they support. Supporting our business development team members are our program managers, who are organized by product and focus on designing optimal solutions and contract fulfillment, as well as internalizing feedback from customers and users. By maintaining assigned points of contact with our customers, we believe that we are able to enhance our relationships, service existing contracts effectively and gain vital feedback to improve our responsiveness and product offerings.

**Industrial Electric Vehicle Charging Systems**

We primarily sell our PosiCharge industrial electric vehicle charging systems through a dedicated, direct sales force whose members are located in close proximity to the customers they support. The sales team targets large entities with the potential for domestic and international enterprise adoption of our solutions. In addition to our direct customer sales, we also employ a regional sales team that coordinates distribution of PosiCharge industrial electric vehicle charging systems through battery and lift truck dealers. These dealers' relationships with, and proximity to, our customers' facilities enable them to sell our solutions and provide post-sale service to our customers. We believe that these dealers are well suited to address the large number of smaller and geographically dispersed customers with industrial vehicle fleets. When evaluating a facility for its ability to benefit from PosiCharge industrial electric vehicle charging systems, we perform a detailed analysis of the customer's operations. This analysis allows us to quantify the benefit projected for a PosiCharge system implementation, helping customers to determine for themselves if the business case is sufficiently compelling.

**Power Cycling and Test Systems**

We sell our power cycling and test systems through a dedicated, direct sales force and through a network of international distributors and representatives who have access to the research and development and manufacturing organizations that procure and use these types of systems. Given the distances involved, we enable and rely on our international distributors to provide service in support of our customers.

Table of Contents

**Passenger and Fleet Plug-In Electric and Hybrid Vehicle Charging Systems**

As the market for plug-in electric and hybrid vehicles emerges, we are pursuing numerous potential sales channels for our products and services. We seek to partner with auto manufacturers, utilities, government agencies and private enterprises, both domestically and abroad, to position ourselves for the potential demand for charging solutions associated with plug-in electric and hybrid vehicles adoption. We are also developing the capability to sell directly to consumers. We are developing a nationwide network of licensed electrical contractors who we train and certify to install and service home charging systems. To enable this installation and service network we are developing an ecommerce platform that will integrate customers' orders, inventory management, dispatching and provisioning, billing and traceability. This platform, along with our nationwide network is designed to support our growth as we pursue numerous electric vehicle charging opportunities.

**International Sales**

We are increasing our sales efforts abroad and have contracted with international sales representatives for our segments in a variety of foreign markets. Our international sales accounted for approximately 7% of our revenue for the fiscal year ended April 30, 2010.

**Manufacturing and Operations**

We pursue a common lean and efficient production system strategy across our product lines, focusing on rapid prototyping, supply chain management, final assembly, and integration quality and final acceptance testing. Using concurrent engineering techniques within an integrated product team structure, we rapidly prototype design concepts and products and optimize our designs for manufacturing requirements, mission capabilities and customer specifications. Within this framework, we develop our products with feedback and input from manufacturing, quality, supply chain management, key suppliers, logistics personnel and customers. We rapidly incorporate this input into the design to ensure maximum efficiency and quality in our products. As a result, we believe that we can significantly reduce the time required to move a product from its design phase to full-rate production deliveries with high reliability, quality and yields.

We outsource certain production activities, such as the fabrication of structures and the manufacture of subassemblies and payloads, to qualified suppliers with whom we have long-term relationships. This outsourcing enables us to focus on final assembly system integration, and test processes for our products, ensuring high levels of quality and reliability. We believe that our efficient supply chain is a significant strength of our manufacturing strategy. We have forged strong relationships with our key suppliers that we believe will allow us to continue to grow our manufacturing capabilities and execute our growth plans. We continue to expand upon our suppliers' expertise to improve our existing products and develop new solutions. We rely on both single and multiple suppliers for certain components and subassemblies. See "Risk Factors If critical components of our products that we currently purchase from a small number of suppliers or raw materials used to manufacture our products become scarce or unavailable, then we may incur delays in manufacturing and delivery of our products, which could damage our business" for more information. All of our production system operations incorporate internal and external quality programs and processes to increase acceptance rates, reduce lead times and lower cost.

**UAS Manufacturing and Operations**

We have successfully developed the manufacturing infrastructure to produce small UAS products at high rates, support initial low rate production for new small UAS development programs and execute initial low-rate production of our stratospheric persistent UAS, Global Observer. Continued investment in infrastructure has established our manufacturing capability to meet demand with scalable capacity.

Table of Contents

By drawing upon experienced personnel across various manufacturing industries (aerospace, automotive, volume commodity) we have progressed in establishing our lean production system and leveraging our International Organization for Standardization, or ISO, certification, integrated supply chain strategy, document control systems, and process control methodologies for a high volume, efficient production system. Presently, our small UAS manufacturing is performed at our 85,000 square foot manufacturing facility established in 2005 in Simi Valley, California. This ISO 9001:2000 certified manufacturing facility is designed to accommodate demand of up to 1,000 aircraft per month. ISO 9001:2000 refers to a set of voluntary standards for quality management systems. These standards are established by the ISO to govern quality management systems used worldwide. Companies that receive ISO certification have passed audits performed by a Registrar Accreditation Board-certified auditing company. These audits evaluate the effectiveness of companies' quality management systems and their compliance with ISO standards. Some companies and government agencies view ISO certification as a positive factor in supplier assessments. Also in Simi Valley, California, our 105,000 square foot facility for Global Observer is equipped with specialized testing and production capabilities to enable low rate production of this unique system.

**Efficient Energy Systems Manufacturing and Operations**

We perform assembly and testing of our power cycling and test systems at a 20,000 square foot, ISO 9001:2000 certified facility located in Monrovia, California. We designed this facility for flexibility, using a work cell model for final assembly, and have included fixtures optimized for final testing. We utilize contract manufacturing for the production of the majority of our PosiCharge industrial electric vehicle charging systems. We are also implementing a contract manufacturing strategy for our emerging passenger and fleet plug-in electric and hybrid vehicle charging systems opportunity.

**Competition**

We believe that the principal competitive factors in the markets for our products and services include product performance, features, acquisition cost, lifetime operating cost, including maintenance and support, ease of use, integration with existing equipment, quality, reliability, customer support, brand and reputation.

The market for small UAS is evolving rapidly and subject to changing technologies, shifting customer needs and expectations and the potential introduction of new products. We believe that a number of established domestic and international defense contractors have developed or are developing small UAS that will continue to compete directly with our products. Some of these contractors have significantly more financial and other resources than we possess. Our current principal small UAS competitors include Elbit Systems Ltd., L-3 Communications Holdings Inc. and Lockheed Martin Corporation. We do not view large UAS such as Northrop Grumman Corporation's Global Hawk, General Atomics, Inc.'s Predator, The Boeing Company's ScanEagle and Textron's Shadow as direct competitors to our small UAS because they perform different missions, do not typically deliver their information directly to front-line ground forces and are not hand launched and controlled, although we cannot be certain that these platforms will not become direct competitors in the future.

The market for high altitude long endurance UAS is in its early stages of development. As a result, this category is not well defined and is characterized by multiple potential solutions. Existing contractors that claim to provide long endurance UAS include Northrop Grumman with its Global Hawk. Several large aerospace and defense contractors are pursuing this market opportunity with proposed very long duration UAS, including The Boeing Company, Qinetiq, Aurora Flight Sciences and Lockheed Martin and Northrop Grumman. Companies pursuing airships as a solution for this market include Lockheed Martin. Companies pursuing satellites as a solution for this market include The Boeing Company, Lockheed Martin, General Dynamics, EADS, Ball Aerospace and Orbital Sciences.

Table of Contents

An established market for man-portable, high-precision loitering miniature airborne munitions systems does not currently exist. The successful introduction of our Switchblade system could establish this market, and if so, would likely attract potential competitors that could range from large aerospace and defense prime contractors to smaller, more innovative technology developers.

The primary direct competitors to PosiCharge systems are other fast charge suppliers, including Aker Wade Power Technologies LLC, PowerDesigners, LLC and ECotality. Some of the major industrial battery suppliers have aligned themselves with fast charge suppliers, creating a potentially more significant source of competition. In addition, our PosiCharge industrial electric vehicle charging systems compete against the traditional method of battery changing. Competitors in this area include suppliers of battery changing equipment and infrastructure, designers of battery changing rooms, battery manufacturers and dealers who may experience reduced sales volume because PosiCharge systems reduces or eliminate the need for extra batteries.

Competitors in the emerging market for passenger and fleet plug-in electric and hybrid vehicle charging systems include charging system suppliers such as Coulomb Technologies, ECotality and ClipperCreek. Potential competitors include large industrial electrical device suppliers such as Eaton Corporation, General Electric Company and Siemens AG.

Direct competitors for our power cycling and test systems include Bitrode Corporation and Digatron Firing Circuits.

**Regulation**

Due to the fact that we contract with the DoD and other agencies of the U.S. government, we are subject to extensive federal regulations, including the Federal Acquisition Regulations, Defense Federal Acquisitions Regulations, Truth in Negotiations Act, Foreign Corrupt Practices Act, False Claims Act and the regulations promulgated under the DoD Industrial Security Manual, which establishes the security guidelines for classified programs and facilities as well as individual security clearances. The federal government audits and reviews our performance on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. Like most government contractors, our contracts are audited and reviewed on a continual basis by federal agencies, including the Defense Contract Management Agency, or DCMA and the Defense Contract Audit Agency, or DCAA.

Certain of these regulations carry substantial penalty provisions, including suspension or debarment from government contracting or subcontracting for a period of time if we are found to be in violation. We carefully monitor all of our contracts and contractual efforts to minimize the possibility of any violation of these regulations.

In addition, we are subject to industry-specific regulations due to the nature of the products and services we provide.

For example, we are subject to further U.S. government regulation, including by the Federal Aviation Administration, or FAA, which regulates airspace for all air vehicles, by the National Telecommunications and Information Administration and Federal Communications Commission, which regulate the wireless communications upon which our small UAS depend, and under the International Traffic in Arms Regulations, which regulate the export of controlled technical data, defense articles and defense services. In 2006, the FAA issued a clarification of its existing policies stating that, in order to engage in public use of small UAS in the U.S. National Airspace System, a public (government) operator must obtain a Certificate of Authorization, or COA, from the FAA or fly in restricted airspace. The FAA's COA approval process requires that the public operator certify the airworthiness of the aircraft for its intended purpose, that a collision with another aircraft or other airspace user is extremely improbable, that the small UAS complies with appropriate cloud and terrain clearances and that the operator or spotter of the small UAS is generally within one half-mile laterally and 400 feet

Table of Contents

vertically of the small UAS while in operation. Furthermore, the FAA's clarification of existing policy states that the rules for radio-controlled hobby aircraft do not apply to public or commercial use of small UAS. The FAA is in the process of drafting updated regulations specifically for small UAS operations. We have engaged in discussions with the FAA to help ensure that these new regulations allow for the maximum safe utilization of our small UAS.

Furthermore, our non-U.S. operations are subject to the laws and regulations of foreign jurisdictions, which may include regulations that are more stringent than those imposed by the U.S. government on our U.S. operations.

**Government Contracting Process**

We sell the significant majority of our small UAS products and services as the prime contractor under contracts with the U.S. government. Certain important aspects of our government contracts are described below.

**Bidding Process**

We are awarded government contracts either on a sole-source basis or through a competitive bidding process. Most of our current government contracts were awarded through a competitive bidding process. The U.S. government awards competitive-bid contracts based on proposal evaluation criteria established by the procuring agency. Competitive-bid contracts are awarded after a formal bid and proposal competition among providers. Interested contractors prepare a bid and proposal in response to the agency's request for proposal or request for information. A bid and proposal is usually prepared in a short time period in response to a deadline and requires the extensive involvement of numerous technical and administrative personnel. Following award, competitive-bid contracts may be challenged by unsuccessful bidders.

**Funding**

The funding of U.S. government programs is subject to congressional appropriations. Although multi-year contracts may be authorized in connection with major procurements, Congress generally appropriates funds on a fiscal year basis, even though a program may continue for many years. Consequently, programs are often only partially funded initially, and additional funds are committed only as Congress makes further appropriations.

The contracts for our full-rate production UAS are funded either through operational needs statements or as programs of record. Operational needs statements represent allocations of discretionary spending or reallocations of funding from other government programs. Funding for our production of initial Raven deliveries was provided through operational needs statements. We define a program of record as a program which, after undergoing extensive DoD review and product testing, is included in the five-year government budget cycle, meaning that funding will be allocated for purchases under these contracts during the five-year cycle, absent affirmative action by the customer or Congress to change the budgeted amount. Funding for these programs is subject to annual approval. We are currently the sole provider and prime contractor under all of the programs of record established by the DoD for small UAS.

Table of Contents

**Material Government Contract Provisions**

All contracts with the U.S. government contain provisions, and are subject to laws and regulations, that give the government rights and remedies not typically found in commercial contracts, including rights that allow the government to:

terminate existing contracts for convenience, which affords the U.S. government the right to terminate the contract in whole or in part anytime it wants for any reason or no reason, as well as for default;

reduce or modify contracts or subcontracts, if its requirements or budgetary constraints change;

cancel multi-year contracts and related orders, if funds for contract performance for any subsequent year become unavailable;

claim rights in products and systems produced by its contractors if the contract is cost reimbursable and the contractor produces the products or systems during the performance of the contract;

adjust contract costs and fees on the basis of audits completed by its agencies;

suspend or debar a contractor from doing business with the U.S. government; and

control or prohibit the export of products.

Generally, government contracts are subject to oversight audits by government representatives. Provisions in these contracts permit termination, in whole or in part, without prior notice, at the government's convenience or upon contractor default under the contract. Compensation in the event of a termination, if any, is limited to work completed at the time of termination. In the event of termination for convenience, the contractor may receive a certain allowance for profit on the work performed.

**Government Contract Categories**

We have three types of government contracts, each of which involves a different payment methodology and level of risk related to the cost of performance. These basic types of contracts are typically referred to as fixed-price contracts, cost reimbursable contracts (including cost-plus-fixed fee, cost-plus-award fee, and cost-plus-incentive fee) and time-and-materials contracts.

In some cases, depending on the urgency of the project and the complexity of the contract negotiation, we will enter into a Letter Contract prior to finalizing the terms of a definitive fixed-price, cost reimbursable or time-and-materials definitive contract. A Letter Contract is a written preliminary contractual instrument that provides limited initial funding and authorizes us to begin immediately manufacturing supplies or performing services while negotiating the definitive terms of the procurement.

**Fixed-Price.** These contracts are not subject to adjustment by reason of costs incurred in the performance of the contract. With this type of contract, we assume the risk that we will not be able to perform at a cost below the fixed-price, except for costs incurred because of contract changes ordered by the customer. Upon the U.S. government's termination of a fixed-price contract, generally we would be entitled to payment for items delivered to and accepted by the U.S. government and, if the termination is at the U.S. government's convenience, for payment of fair compensation for work performed plus the costs of settling and paying claims by any terminated subcontractors, other settlement expenses and a reasonable allowance for profit on the costs incurred.

**Cost Reimbursable.** Cost reimbursable contracts include cost-plus-fixed fee contracts, cost-plus-award fee contracts and cost-plus-incentive fee contracts. Under each type of contract, we





Table of Contents

assume the risk that we may not be able to recover costs if they are not allowable under the contract terms or applicable regulations, or if the costs exceed the contract funding.

Cost-plus-fixed fee contracts are cost reimbursable contracts that provide for payment of a negotiated fee that is fixed at the inception of the contract. This fixed fee does not vary with actual cost of the contract, but may be adjusted as a result of changes in the work to be performed under the contract. This contract type poses less risk of loss than a fixed-price contract, but our ability to win future contracts from the procuring agency may be adversely affected if we fail to perform within the maximum cost set forth in the contract.

A cost-plus-award fee contract is a cost reimbursable contract that provides for a fee consisting of a base amount (which may be zero) fixed at inception of the contract and an award amount, based upon the government's satisfaction with the performance under the contract. With this type of contract, we assume the risk that we may not receive the award fee, or only a portion of it, if we do not perform satisfactorily.

A cost-plus-incentive fee contract is a cost reimbursable contract that provides for an initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs.

We typically experience lower profit margins and lower risk under cost reimbursable contracts than under fixed-price contracts. Upon the termination of a cost reimbursable contract, generally we would be entitled to reimbursement of our allowable costs and, if the termination is at the U.S. government's convenience, a total fee proportionate to the percentage of work completed under the contract.

***Time-and-Materials.*** Under a time-and-materials contract, our compensation is based on a fixed hourly rate established for specified labor or skill categories. We are paid at the established hourly rates for the hours we expend performing the work specified in the contract. Labor costs, overhead, general and administrative costs and profit are included in the fixed hourly rate. Materials, subcontractors, travel and other direct costs are reimbursed at actual costs plus an amount for material handling. We make critical pricing assumptions and decisions when developing and proposing time-and-materials labor rates. We risk reduced profitability if our actual costs exceed the costs incorporated into the fixed hourly labor rate. One variation of a standard time-and-materials contract is a time-and-materials, award fee contract. Under this type of contract, a positive or negative incentive can be earned based on achievement against specific performance metrics.

**Indefinite Delivery Indefinite Quantity Contract Form**

The U.S. government frequently uses indefinite delivery, indefinite quantity contracts, known as IDIQ contracts, and IDIQ-type contract forms such as cost reimbursable and fixed price contracts with multiple one-year options, to obtain fixed-price, cost reimbursable and time-and-materials contractual commitments to provide products or services over a period of time pursuant to established general terms and conditions. At the time of the award of an IDIQ contract or IDIQ-type contract, the U.S. Government generally commits to purchase only a minimal amount of products or services from the contractor to whom such contract is awarded.

After award of an IDIQ contract, the U.S. Government may issue task orders for specific services or products it needs. The competitive process to obtain task orders under an award contract is limited to the pre-selected contractors. If such contract has a single prime contractor, then the award of task orders is limited to that contractor. If the contract has multiple prime contractors, then the award of the task order is competitively determined among only those prime contractors.

IDIQ and IDIQ-type contracts typically have multi-year terms and unfunded ceiling amounts which enable, but do not commit, the U.S. government to purchase substantial amounts of products and services from one or more contractors.

Table of Contents

**Contract Mix**

The table below shows our revenue for the periods indicated by contract type, including both government and commercial sales:

	Fiscal Year Ended		
	April 30,		
	2010	2009	2008
Fixed-price contracts	59%	59%	59%
Cost reimbursable contracts	40%	40%	40%
Time-and-materials contracts	1%	1%	1%

**Employees**

As of April 30, 2010, we had 732 full-time employees, of whom 299 were in research and development and engineering, 64 were in sales and marketing, 238 were in operations and 131 were general and administrative personnel. We believe that we have a good relationship with our employees.

**Other Information**

AeroVironment, Inc. was originally incorporated in the State of California in July 1971 and reincorporated in Delaware in 2006. In January 2007, we completed an initial public offering which resulted in the issuance of 5,252,285 shares of our common stock at a price of \$17.00 per share, resulting in net proceeds to us of approximately \$80.5 million, after deducting payment of underwriters' discounts and commissions and offering expenses.

Our principal executive offices are located at 181 W. Huntington Dr., Suite 202, Monrovia, California 91016. Our telephone number is (626) 357-9983. Our website home page on the Internet is <http://www.avinc.com>. We make our website content available for information purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference into this Form 10-K.

We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statement for our annual stockholders' meeting, as well as any amendments to those reports, available free of charge through our website as soon as reasonably practical after we electronically file that material with, or furnish it to, the SEC. You can learn more about us by reviewing our SEC filings. Our SEC reports can be accessed through the investor relations page of our web site at <http://investor.avinc.com>. These reports may also be obtained at the SEC's public reference room at 100 F. Street, N.E., Washington, DC 20549. The SEC also maintains a web site at [www.sec.gov](http://www.sec.gov) that contains reports, proxy statements and other information regarding the Company.

**Item 1A. Risk Factors.**

***We rely heavily on sales to the U.S. government, particularly to agencies of the Department of Defense.***

Historically, a significant portion of our total sales and substantially all of our small UAS sales have been to the U.S. government and its agencies. Sales to the U.S. government, either as a prime contractor or subcontractor, represented approximately 86% of our revenue for the fiscal year ended April 30, 2010. The DoD, our principal U.S. government customer, accounted for approximately 80% of our revenue for the fiscal year ended April 30, 2010. We believe that the success and growth of our business for the foreseeable future will continue to depend on our ability to win government contracts, in particular from the DoD. Many of our government customers are subject to budgetary constraints and our continued performance under these contracts, or award of additional contracts from these agencies, could be jeopardized by spending reductions or budget cutbacks at these agencies. The funding of U.S. government programs is uncertain and dependent on continued congressional appropriations and administrative allotment of funds based on an annual budgeting process. We cannot

Table of Contents

assure you that current levels of congressional funding for our products and services will continue. Furthermore, all of our contracts with the U.S. government are terminable by the U.S. government at will. A significant decline in government expenditures generally, or with respect to programs for which we provide products, could adversely affect our business and prospects. Our operating results may also be negatively impacted by other developments that affect these government programs generally, including the following:

changes in government programs that are related to our products and services;

adoption of new laws or regulations relating to government contracting or changes to existing laws or regulations;

changes in political or public support for security and defense programs;

delays or changes in the government appropriations process;

uncertainties associated with the current global threat environment and other geo-political matters; and

delays in the payment of our invoices by government payment offices.

These developments and other factors could cause governmental agencies to reduce their purchases under existing contracts, to exercise their rights to terminate contracts at-will or to abstain from renewing contracts, any of which would cause our revenue to decline and could otherwise harm our business, financial condition and results of operations.

***Military transformation and operational levels in Afghanistan and Iraq may affect future procurement priorities and existing programs, which could limit demand for our UAS.***

Following the end of the Cold War, the U.S. military began a transformation of its operational concepts, organizational structure and technologies in an effort to improve warfighting capabilities. The resulting shift in procurement priorities toward achieving these capabilities, together with the current high level of operational activity in Afghanistan and Iraq, have led to an increase in demand for our small UAS. We cannot predict whether current or future changes in priorities due to defense transformation or continuation of the current nature and magnitude of operations in Afghanistan and Iraq will afford new opportunities for our small UAS business in terms of existing, additional or replacement programs. Furthermore, we cannot predict whether or to what extent this defense transformation or current operational levels in Afghanistan or Iraq will continue. If defense transformation or operations in Afghanistan and Iraq cease or slow down, then our business, financial condition and results of operations could be impacted.

***We operate in evolving markets, which makes it difficult to evaluate our business and future prospects.***

UAS, electric vehicle charging systems and other energy technologies that we offer are sold in new and rapidly evolving markets. Accordingly, our business and future prospects are difficult to evaluate. We cannot accurately predict the extent to which demand for our products will increase, if at all. The challenges, risks and uncertainties frequently encountered by companies in rapidly evolving markets could impact our ability to do the following:

generate sufficient revenue to maintain profitability;

acquire and maintain market share;

Edgar Filing: AeroVironment Inc - Form 10-K

manage growth in our operations;

develop and renew contracts;

attract and retain additional engineers and other highly-qualified personnel;

Table of Contents

successfully develop and commercially market new products;

adapt to new or changing policies and spending priorities of governments and government agencies; and

access additional capital when required and on reasonable terms.

If we fail to address these and other challenges, risks and uncertainties successfully, our business, results of operations and financial condition would be materially harmed.

***We face competition from other firms, many of which have substantially greater resources.***

The defense industry is highly competitive and generally characterized by intense competition to win contracts. Our current principal small UAS competitors include Elbit Systems Ltd., L-3 Communications Holdings Inc. and Lockheed Martin Corporation. We do not view large UAS such as Northrop Grumman Corporation's *Global Hawk*, General Atomics, Inc.'s *Predator*, The Boeing Company's *ScanEagle* and Textron Inc.'s *Shadow* as direct competitors because they perform different missions, do not typically deliver their information directly to front-line ground forces, and are not hand launched and controlled, although we cannot be certain that these platforms will not become direct competitors in the future. Some of these firms have substantially greater financial, management, research and marketing resources than we have.

The primary direct competitors to our PosiCharge business are other fast charge suppliers, including Aker Wade Power Technologies LLC, PowerDesigners, LLC and ECotality, as well as industrial battery manufacturers who distribute fast charge systems from these suppliers. The primary direct competitors to our electric vehicle test system business are other test system suppliers, including Bitrode Corporation and Digatron Firing Circuits. Our primary competitors in the emerging market for passenger and fleet electric vehicle charging systems include charging system suppliers such as Coulomb Technologies, ECotality and ClipperCreek.

Our competitors may be able to provide customers with different or greater capabilities or benefits than we can provide in areas such as technical qualifications, past contract performance, geographic presence, price and the availability of key professional personnel, including those with security clearances. Furthermore, many of our competitors may be able to utilize their substantially greater resources and economies of scale to develop competing products and technologies, divert sales away from us by winning broader contracts or hire away our employees by offering more lucrative compensation packages. In the event that the market for small UAS or electric vehicle charging systems expands, we expect that competition will intensify as additional competitors enter the market and current competitors expand their product lines. In order to secure contracts successfully when competing with larger, well-financed companies, we may be forced to agree to contractual terms that provide for lower aggregate payments to us over the life of the contract, which could adversely affect our margins. In addition, larger diversified competitors serving as prime contractors may be able to supply underlying products and services from affiliated entities, which would prevent us from competing for subcontracting opportunities on these contracts. Our failure to compete effectively with respect to any of these or other factors could have a material adverse effect on our business, prospects, financial condition or operating results.

***If the UAS and electric vehicle charging and testing systems markets do not experience significant growth, if we cannot expand our customer base or if our products do not achieve broad acceptance, then we will not be able to achieve our anticipated level of growth.***

For the fiscal year ended April 30, 2010, UAS, and Efficient Energy Systems, accounted for 90% and 10% of our total revenue, respectively. We cannot accurately predict the future growth rates or sizes of these markets. Demand for our products may not increase, or may decrease, either generally or

Table of Contents

in specific markets, for particular types of products or during particular time periods. We believe the market for electric vehicle charging and test systems is young and has not yet matured or diversified. Moreover, there are only a limited number of major programs under which the U.S. military, our primary customer, is currently funding the development or purchase of UAS. Although we are seeking to expand our customer base to include foreign governments, domestic non-military agencies and commercial customers, we cannot assure you that our efforts will be successful. The expansion of the UAS and electric vehicle charging and test systems markets in general, and the market for our products in particular, depends on a number of factors, including the following:

customer satisfaction with these types of systems as solutions;

the cost, performance and reliability of our products and products offered by our competitors;

customer perceptions regarding the effectiveness and value of these types of systems;

the rate of adoption of plug-in electric and hybrid vehicles;

limitations on our ability to market our small UAS products outside the United States due to U.S. government regulations;

obtaining timely regulatory approvals, including, with respect to our small UAS business, access to airspace and wireless spectrum; and

marketing efforts and publicity regarding these types of systems.

Even if UAS and electrical vehicle charging and test systems gain wide market acceptance, our products may not adequately address market requirements and may not continue to gain market acceptance. If these types of systems generally, or our products specifically, do not gain wide market acceptance, then we may not be able to achieve our anticipated level of growth and our revenue and results of operations would suffer.

***If critical components of our products that we currently purchase from a small number of suppliers or raw materials used to manufacture our products become scarce or unavailable, then we may incur delays in manufacturing and delivery of our products, which could damage our business.***

We obtain hardware components and various subsystems from a limited group of suppliers. We do not have long-term agreements with any of these suppliers that obligate them to continue to sell components or products to us. Our reliance on these suppliers involves significant risks and uncertainties, including whether our suppliers will provide an adequate supply of required components of sufficient quality, will increase prices for the components and will perform their obligations on a timely basis.

In addition, certain raw materials and components used in the manufacture of our products are periodically subject to supply shortages, and our business is subject to the risk of price increases and periodic delays in delivery. Similarly, the market for electronic components is subject to cyclical reductions in supply. If we are unable to obtain components from third-party suppliers in the quantities and of the quality that we require, on a timely basis and at acceptable prices, then we may not be able to deliver our products on a timely or cost-effective basis to our customers, which could cause customers to terminate their contracts with us, increase our costs and seriously harm our business, results of operations and financial condition. Moreover, if any of our suppliers become financially unstable, then we may have to find new suppliers. It may take several months to locate alternative suppliers, if required, or to redesign our products to accommodate components from different suppliers. We may experience significant delays in manufacturing and shipping our products to customers and incur additional development, manufacturing and other costs to establish alternative sources of supply if we lose any of these sources or are required to redesign our products. We cannot



Table of Contents

predict if we will be able to obtain replacement components within the time frames that we require at an affordable cost, if at all.

***Any efforts to expand our product offerings beyond our current markets may not succeed, which could negatively impact our operating results.***

We have focused on selling our small UAS to the U.S. military and our industrial electric vehicle fast charging and test systems to large industrial electric vehicle fleet operators primarily in North America and our power cycling and test systems primarily to R&D facilities in North America. We plan, however, to seek to expand our UAS sales into other government and commercial markets and our industrial electric vehicle charging and test systems sales into international markets. Efforts to expand our product offerings beyond the markets that we currently serve may divert management resources from existing operations and require us to commit significant financial resources to unproven businesses that may not generate additional sales, either of which could significantly impair our operating results.

***Our failure to obtain necessary regulatory approvals from the FAA or other appropriate governmental agency may prevent us from expanding the sales of our small UAS to non-military customers in the United States and require us to incur additional costs in the testing of our products.***

In 2006, the FAA issued a clarification of its existing policies stating that, in order to engage in public use of small UAS in the U.S. National Airspace System, a public (government) operator must obtain a Certificate of Authorization, or COA, from the FAA or fly in restricted airspace. The FAA's COA approval process requires that the public operator certify the airworthiness of the aircraft for its intended purpose, that a collision with another aircraft or other airspace user is extremely improbable, that the small UAS complies with appropriate cloud and terrain clearances and that the operator or spotter of the small UAS is generally within one half-mile laterally and 400 feet vertically of the small UAS while in operation. Furthermore, the FAA's clarification of existing policy states that the rules for radio-controlled hobby aircraft do not apply to public or commercial use of small UAS. The FAA is in the process of drafting updated regulations specifically for small UAS operations, but we cannot assure you that these regulations will allow the use of our small UAS by potential non-military government and commercial customers. If the FAA does not modify its regulations, we may not be able to expand our sales of UAS beyond our military customers, which could harm our business prospects. In addition, if our DoD customers are unable to obtain COAs, we may not be able to perform our flight tests without incurring the additional costs of transporting our small UAS products to military installations, when restricted airspace is available for testing, which could impair our operating results.

***The markets in which we compete are characterized by rapid technological change, which requires us to develop new products and product enhancements, and could render our existing products obsolete.***

Continuing technological changes in the market for our products could make our products less competitive or obsolete, either generally or for particular applications. Our future success will depend upon our ability to develop and introduce a variety of new capabilities and enhancements to our existing product offerings, as well as introduce a variety of new product offerings, to address the changing needs of the markets in which we offer our products. Delays in introducing new products and enhancements, the failure to choose correctly among technical alternatives or the failure to offer innovative products or enhancements at competitive prices may cause existing and potential customers to purchase our competitors' products.

If we are unable to devote adequate resources to develop new products or cannot otherwise successfully develop new products or enhancements that meet customer requirements on a timely basis, our products could lose market share, our revenue and profits could decline, and we could experience operating losses.



Table of Contents

***We expect to incur substantial research and development costs and devote significant resources to identifying and commercializing new products, which could significantly reduce our profitability and may never result in revenue to us.***

Our future growth depends on penetrating new markets, adapting existing products to new applications, and introducing new products that achieve market acceptance. We plan to incur substantial research and development costs as part of our efforts to design, develop and commercialize new products and enhance existing products. We spent \$24.5 million, or 10% of our revenue, in our fiscal year ended April 30, 2010 on research and development activities and expect to continue to spend significant funds on research and development in the future. Because we account for research and development as an operating expense, these expenditures will adversely affect our earnings in the future. Further, our research and development program may not produce successful results, and our new products may not achieve market acceptance, create additional revenue or become profitable, which could materially harm our business, prospects, financial results and liquidity.

***If we are unable to manage our growth, our business could be adversely affected.***

Our headcount and operations have grown rapidly. This rapid growth has placed, and will continue to place, a significant strain on our management and our administrative, operational and financial infrastructure. We anticipate further growth of headcount and facilities will be required to address increases in our product offerings and the geographic scope of our customer base. Our success will depend in part upon the ability of our senior management to manage this growth effectively. To do so, we must continue to hire, train, manage and integrate a significant number of qualified managers and engineers. If our new employees perform poorly, or if we are unsuccessful in hiring, training, managing and integrating these new employees, or retaining these or our existing employees, then our business may suffer.

For us to continue our growth, we must continue to improve our operational, financial and management information systems. If we are unable to manage our growth while maintaining our quality of service, or if new systems that we implement to assist in managing our growth do not produce the expected benefits, then our business, prospects, financial condition or operating results could be adversely affected.

***Our earnings and profit margins may decrease based on the mix of our contracts and programs and other factors related to our contracts.***

In general, we perform our production work under fixed-price contracts and our repair and customer-funded research and development work under cost-plus-fee contracts. Under fixed-price contracts, we perform services under a contract at a stipulated price. Under cost-plus-fee contracts, which are subject to a contract ceiling amount, we are reimbursed for allowable costs and paid a fee, which may be fixed or performance based. We typically experience lower profit margins under cost-plus-fee contracts than under fixed-price contracts, though fixed-price contracts have higher risks. In general, if the volume of services we perform under cost-plus-fee contracts increases relative to the volume of services we perform under fixed-price contracts, we expect that our operating margin will suffer. In addition, our earnings and margins may decrease depending on the costs we incur in contract performance, our achievement of other contract performance objectives and the stage of our performance at which our right to receive fees, particularly under incentive and award fee contracts, is finally determined.

***Our senior management and key employees are important to our customer relationships and overall business.***

We believe that our success depends in part on the continued contributions of our senior management and key employees. We rely on our executive officers, senior management and key

Table of Contents

employees to generate business and execute programs successfully. In addition, the relationships and reputation that members of our management team and key employees have established and maintain with government defense personnel contribute to our ability to maintain good customer relations and to identify new business opportunities. We do not have employment agreements with any of our executive officers or key employees, and these individuals could terminate their employment with us at any time. The loss of any of our executive officers, members of our senior management team or key employees could significantly delay or prevent the achievement of our business objectives and could materially harm our business and customer relationships and impair our ability to identify and secure new contracts and otherwise manage our business.

***We must recruit and retain highly-skilled employees to succeed in our competitive business.***

We depend on our ability to recruit and retain employees who have advanced engineering and technical services skills and who work well with our customers. These employees are in great demand and are likely to remain a limited resource in the foreseeable future. If we are unable to recruit and retain a sufficient number of these employees, then our ability to maintain our competitiveness and grow our business could be negatively affected. In addition, because of the highly technical nature of our products, the loss of any significant number of our existing engineering personnel could have a material adverse effect on our business and operating results. Moreover, some of our U.S. government contracts contain provisions requiring us to staff a program with certain personnel the customer considers key to our successful performance under the contract. In the event we are unable to provide these key personnel or acceptable substitutes, the customer may terminate the contract.

***Our business may be dependent upon our employees obtaining and maintaining required security clearances.***

Certain of our U.S. government contracts require our employees to maintain various levels of security clearances, and we are required to maintain certain facility security clearances complying with DoD requirements. The DoD has strict security clearance requirements for personnel who work on classified programs. Obtaining and maintaining security clearances for employees involves a lengthy process, and it is difficult to identify, recruit and retain employees who already hold security clearances. If our employees are unable to obtain security clearances in a timely manner, or at all, or if our employees who hold security clearances are unable to maintain the clearances or terminate employment with us, then a customer requiring classified work could terminate the contract or decide not to renew it upon its expiration. In addition, we expect that many of the contracts on which we will bid will require us to demonstrate our ability to obtain facility security clearances and employ personnel with specified types of security clearances. To the extent we are not able to obtain facility security clearances or engage employees with the required security clearances for a particular contract, we may not be able to bid on or win new contracts, or effectively rebid on expiring contracts.

***Cost overruns on our contracts could subject us to losses, decrease our operating margins and adversely affect our future business.***

Fixed-price contracts represented approximately 59% of our revenue for the fiscal year ended April 30, 2010. If we fail to anticipate technical problems, estimate costs accurately or control costs during our performance of fixed-price contracts, then we may incur losses on these contracts because we absorb any costs in excess of the fixed price. Under cost-plus-fee contracts, if costs exceed the contract ceiling or are not allowable under the provisions of the contract or applicable regulations, then we may not be able to obtain reimbursement for all such costs. Under time and materials contracts, we are paid for labor at negotiated hourly billing rates and for certain expenses. Under each type of contract, if we are unable to control the costs we incur in performing under the contract, then our financial condition and results of operations could be materially adversely affected. Cost overruns also may adversely affect our ability to sustain existing programs and obtain future contract awards.

Table of Contents

***Our products are complex and could have unknown defects or errors, which may give rise to claims against us, diminish our brand or divert our resources from other purposes.***

Our UAS rely on complex avionics, sensors, user-friendly interfaces and tightly-integrated, electromechanical designs to accomplish their missions, and our industrial electric vehicle charging and test systems often rely upon the application of intellectual property for which there may have been little or no prior commercial application. Despite testing, our products have contained defects and errors and may in the future contain defects, errors or performance problems when first introduced, when new versions or enhancements are released, or even after these products have been used by our customers for a period of time. These problems could result in expensive and time-consuming design modifications or warranty charges, delays in the introduction of new products or enhancements, significant increases in our service and maintenance costs, exposure to liability for damages, damaged customer relationships and harm to our reputation, any of which could materially harm our results of operations and ability to achieve market acceptance. In addition, increased development and warranty costs could be substantial and could reduce our operating margins.

The existence of any defects, errors, or failures in our products or the misuse of our products could also lead to product liability claims or lawsuits against us. A defect, error or failure in one of our UAS could result in injury, death or property damage and significantly damage our reputation and support for UAS in general. While our PosiCharge industrial electric charging systems include certain safety mechanisms, these systems can deliver up to 600 amps of current in their application, and the failure, malfunction or misuse of these systems could result in injury or death. Similarly, the charging systems which we are currently developing for passenger and fleet plug-in electric and hybrid vehicle charging also have the potential to cause injury, death or property damage in the event that they are misused, malfunction or fail to operate properly due to unknown defects or errors. Although we maintain insurance policies, we cannot assure you that this insurance will be adequate to protect us from all material judgments and expenses related to potential future claims or that these levels of insurance will be available in the future at economical prices or at all. A successful product liability claim could result in substantial cost to us. Even if we are fully insured as it relates to a claim, the claim could nevertheless diminish our brand and divert management's attention and resources, which could have a negative impact on our business, financial condition and results of operations.

***The operation of UAS in urban environments may be subject to risks, such as accidental collisions and transmission interference, which may limit demand for our UAS in such environments and harm our business and operating results.***

Urban environments may present certain challenges to the operators of UAS. UAS may accidentally collide with other aircraft, persons or property, which could result in injury, death or property damage and significantly damage the reputation of and support for UAS in general. While we are aware of only one instance of an accidental collision involving an UAS to date, as the usage of UAS has increased, particularly by military customers in urban areas of Afghanistan and Iraq, the danger of such collisions has increased. Furthermore, the incorporation of our DDL technology into our UAS has increased the number of vehicles which can operate simultaneously in a given area and with this increase has come an increase in the risk of accidental collision. In addition, obstructions to effective transmissions in urban environments, such as large buildings, may limit the ability of the operator to utilize the aircraft for its intended purpose. The risks or limitations of operating UAS in urban environments may limit their value in such environments, which may limit demand for our UAS and consequently materially harm our business and operating results.

Table of Contents

***Our quarterly operating results may vary widely.***

Our quarterly revenue, cash flow and operating results have and may continue to fluctuate significantly in the future due to a number of factors, including the following:

fluctuations in revenue derived from government contracts, including cost-plus-fee contracts and contracts with a performance-based fee structure;

the size and timing of orders from military and other governmental agencies, including increased purchase requests from government customers for equipment and materials in connection with the U.S. government's fiscal year end, which may affect our quarterly operating results;

the mix of products that we sell in the period;

seasonal fluctuations in customer demand for some of our products or services;

unanticipated costs incurred in the introduction of new products;

fluctuations in the adoption of our products in new markets;

changes in the level of tax credits available for research and development spending;

cancellations, delays or contract amendments by our governmental agency customers; and

changes in policy or budgetary measures that adversely affect our governmental agency customers.

Changes in the volume of products and services provided under existing contracts and the number of contracts commenced, completed or terminated during any quarter may cause significant variations in our cash flow from operations because a relatively large amount of our expenses are fixed. We incur significant operating expenses during the start-up and early stages of large contracts and typically do not receive corresponding payments in that same quarter. We may also incur significant or unanticipated expenses when contracts expire or are terminated or are not renewed. In addition, payments due to us from government agencies may be delayed due to billing cycles or as a result of failures of governmental budgets to gain congressional and presidential administration approval in a timely manner.

***Shortfalls in available external research and development funding could adversely affect us.***

We depend on our research and development activities to develop the core technologies used in our small UAS and Efficient Energy Systems products and for the development of our future products. A portion of our research and development activities depends on funding by commercial companies and the U.S. government. U.S. government and commercial spending levels can be impacted by a number of variables, including general economic conditions, specific companies' financial performance and competition for U.S. government funding with other U.S. government-sponsored programs in the budget formulation and appropriation processes. Moreover, the U.S., state and local governments provide energy rebates and incentives to commercial companies, which directly impact the amount of research and development that companies appropriate for energy systems. To the extent that these energy rebates and incentives are reduced or eliminated, company funding for research and development could be reduced. Any reductions in available research and development funding could harm our business, financial condition and operating results.

***Volatility and cyclicity in the market for electric industrial vehicles could adversely affect us.***

## Edgar Filing: AeroVironment Inc - Form 10-K

Our PosiCharge industrial electric vehicle charging system products are purchased primarily by operators of fleets of electric industrial vehicles, such as forklift trucks and airport ground support equipment. Consequently, our ability to remain profitable depends in part on the varying conditions in the market for electric industrial vehicles. This market is subject to volatility as it moves in response to

Table of Contents

cycles in the overall business environment and it is also particularly sensitive to the industrial, food and beverage, retail and air travel sectors, which generate a significant portion of the demand for such vehicles. Sales of electric industrial vehicles have historically been cyclical, with demand affected by such economic factors as industrial production, construction levels, demand for consumer and durable goods, interest rates and fuel costs. A significant decline in demand for electric industrial vehicles could adversely affect our revenue and prospects, which would harm our business, financial condition and operating results.

***Our success in the emerging market for passenger and fleet plug-in electric and hybrid vehicle charging systems will depend on numerous factors which are out of our control.***

The passenger and fleet plug-in electric and hybrid vehicle charging systems market is expected to grow rapidly, along with innovations in fast charging technologies. As a result, we expect to face increasing competition from various charging system suppliers and large industrial electrical device suppliers such as Eaton Corporation, General Electric Company and Siemens AG. While we believe that we currently have superior charging technology and service infrastructure, we cannot assure you that competitors will not develop and bring to market substantially equivalent or superior technology. In addition, because the passenger electric and fleet charging systems market is relatively new, there is no guarantee that there will be strong consumer demand for charging systems. Demand for such systems could also be directly impacted by fuel costs; if fuel costs were to significantly decrease, the demand for electric vehicles and charging systems could decline. If there is little consumer demand for our passenger electric and fleet charging systems, our revenue and prospects could be adversely affected, which would harm our business, financial and operating results.

***Our industrial electric vehicle charging systems business is dependent upon our relationships with third parties with whom we do not have exclusive arrangements.***

To remain competitive in the market for industrial electric vehicle charging systems, we must maintain our access to potential customers and ensure that the service needs of our customers are met adequately. In many cases, we rely on battery and industrial vehicle dealers for access to potential industrial electric vehicle charging system customers. Currently, several of our industrial electric vehicle charging system competitors are working with battery manufacturers to sell fast charge systems and batteries together. Cooperative agreements between our competitors and battery manufacturers could restrict our access to battery dealers and potential industrial electric vehicle charging systems customers, adversely affecting our revenue and prospects. Additionally, we rely on outside service providers to perform post-sale services for our PosiCharge customers. If these service providers fail to perform these services as required or discontinue their business with us, then we could lose customers to competitors, which would harm our business, financial condition and operating results.

***Our plug-in electric and hybrid vehicle charging system business is dependent upon our development of relationships with automakers, utilities and other participants in the plug-in electric and hybrid vehicle and electricity delivery markets.***

In January 2010, we were selected by a major automaker to support the rollout of a new model plug-in electric vehicle across the U.S. Accordingly, we depend upon that relationship and the success of the home charging rollout to those new model plug-in electric vehicle owners to expand our charging system footprint in the U.S. and worldwide. If our partnership with that major automaker terminates prematurely, and we cannot establish similar relationships with other entities with direct access to plug-in electric vehicle owners and drivers, we may not be able to develop a sustainable market for our home charging system, which may delay the commercialization of our charging systems or jeopardize the long-term success of this product line. We believe that the success and growth of our plug-in electric and hybrid vehicle charging system business for the foreseeable future will also depend on our ability to develop similar working relationships with other automakers in the U.S. and internationally.

Table of Contents

While we have been working with other automakers and utilities to explore business models and to promote our solutions, there is no guarantee that we will be successful in doing so.

***We work in international locations where there are high security risks, which could result in harm to our employees and contractors or substantial costs.***

Some of our services are performed in or adjacent to high-risk locations, such as Iraq and Kuwait, where the country or location is suffering from political, social or economic issues, or war or civil unrest. For example, during fiscal 2010, we have had up to ten employees operating in Iraq and/or Kuwait at any one time, both within and outside of U.S. government installations. In those locations where we have employees or operations, we may incur substantial costs to maintain the safety of our personnel. Despite these precautions, the safety of our personnel in these locations may continue to be at risk, and we may in the future suffer the loss of employees and contractors, which could harm our business and operating results.

***We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our stockholders.***

We operate in emerging and rapidly evolving markets, which makes our prospects difficult to evaluate. It is possible that we may not generate sufficient cash flow from operations or otherwise have the capital resources to meet our future capital needs. If this occurs, then we may need additional financing to pursue our business strategies, including to:

hire additional engineers and other personnel;

develop new or enhance existing products;

enhance our operating infrastructure;

fund working capital requirements;

acquire complementary businesses or technologies; or

otherwise respond to competitive pressures.

If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders. We cannot assure you that additional financing will be available on terms favorable to us, or at all. Our former line of credit contained, and future debt financing may contain, covenants or other provisions that limit our operational or financial flexibility. In addition, certain of our customers require that we obtain letters of credit to support our obligations under some of our contracts.

***Our investment portfolio includes investments in auction rate securities. Failures in the auctions for these securities affect our liquidity, while deterioration in credit ratings of issuers of such securities and/or third parties insuring such investments may require us to adjust the carrying value of our investment through an impairment of earnings.***

As of April 30, 2010, our \$6.5 million of long-term investments, recorded at fair value, consisted entirely of auction rate municipal bonds with maturities that range from approximately 9 to 24 years. These investments have characteristics similar to short-term investments, because at pre-determined intervals, generally ranging from 30 to 35 days, there is a new auction process at which the interest rates for these securities are reset to current interest rates. At the end of such period, we choose to roll-over our holdings or redeem the investments for cash. A market maker facilitates the redemption of the securities and the underlying issuers are not required to redeem the investment within 365 days.





Table of Contents

In 2008, 2009 and 2010, we experienced failed auctions of our auction rate securities and there is no assurance that auctions on the remaining auction rate securities in our investment portfolio will succeed in the future. As a result, our ability to liquidate our investments in the near term may be limited, and our ability to recover the carrying value of our investments may be limited. An auction failure means that the parties wishing to sell securities were not able to do so. As of June 11, 2010, including the securities involved in failed auctions, we held approximately \$6.5 million of these auction rate securities, all of which carry investment grade ratings. These investments are subject to general credit, liquidity, market and interest rate risks, which may be exacerbated by continued problems in the global credit markets, including but not limited to, U.S. subprime mortgage defaults, writedowns by major financial institutions due to deteriorating values of their assets portfolios, including leveraged loans, collateralized debt obligations, credit default swaps, and other credit-linked products. These and other related factors have affected various sectors of the financial markets and caused credit and liquidity issues. If the issuers of these securities are unable to successfully close future auctions or their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. We currently believe these securities are not permanently impaired, primarily due to the government backing of the underlying securities. However, it could take until the final maturity of the underlying notes (up to 24 years) to realize our investments' purchase price of \$7.8 million. Based on our ability to access our cash and cash equivalents, expected operating cash flows, and our other sources of cash, we do not anticipate that the current lack of liquidity on these investments will affect our ability to continue to operate our business in the ordinary course, however we can provide no assurance as to when these investments will again become liquid or as to whether we may ultimately have to recognize an impairment charge with respect to these investments.

***We face a number of risks related to the recent financial crisis and severe tightening in the global credit markets.***

The recent global financial crisis affecting the banking system and financial markets has resulted in a severe tightening in credit markets, a low level of liquidity in many financial markets, and extreme volatility in credit and equity markets. The continuing impact of this financial crisis could affect our business in a number of ways, including:

*Potential Deferment of Purchases and Orders by Customers:* Uncertainty about current and future global economic conditions may cause governments, including the U.S. government, which is our largest customer, consumers and businesses to modify, defer or cancel purchases in response to tighter credit, decreased cash availability and declining consumer confidence. Accordingly, future demand for our products could differ materially from our current expectations. Additionally, if customers are not successful in generating sufficient revenue or are precluded from securing financing, they may not be able to pay, or may delay payment of, accounts receivable that are owed to us. Any inability of current and/or potential customers to pay us for our products may adversely affect our earnings and cash flow.

*Negative Impact from Increased Financial Pressures on Key Suppliers:* Our ability to meet customers' demands depends, in part, on our ability to obtain timely and adequate delivery of quality materials, parts and components from our suppliers. Certain of our hardware components and various subsystems are available only from a limited group of suppliers. If certain key suppliers were to become capacity constrained or insolvent as a result of the financial crisis, then we may have to find new suppliers. We may experience significant delays in manufacturing and shipping our products to customers and incur additional development, manufacturing and other costs to establish alternative sources of supply if we lose any of these sources or are required to redesign our products. We cannot predict if we will be able to obtain replacement components within the time frames that we require at an affordable cost, if at all. In addition, credit constraints of key suppliers could result in accelerated payment of accounts payable by us, impacting our cash flow.

Table of Contents

*Customers' Inability to Obtain Financing to Make Purchases from Us and/or Maintain Their Business:* Some of our customers may require substantial financing in order to fund their operations and make purchases from us. The inability of these customers to obtain sufficient credit to finance purchases of our products, or otherwise meet their payment obligations to us could adversely impact our financial condition and results of operations. In addition, if the financial crisis results in insolvencies for our customers, it could adversely impact our financial condition and results of operations.

***Our international business poses potentially greater risks than our domestic business.***

We derived approximately 7% of our revenue from international sales during the fiscal year ended April 30, 2010. We expect to derive an increasing portion of our revenue from international sales. Our international revenue and operations are subject to a number of material risks, including the following:

the unavailability of, or difficulties in obtaining any, necessary governmental authorizations for the export of our UAS products to certain foreign jurisdictions;

regulatory requirements that may adversely affect our ability to sell certain products or repatriate profits to the U.S.;

the complexity and necessity of using foreign representatives and consultants;

difficulties in enforcing agreements and collecting receivables through foreign legal systems and other relevant legal issues, including fewer legal protections for intellectual property;

potential fluctuations in foreign economies and in the value of foreign currencies and interest rates;

potential preferences by prospective customers to purchase from local (non-U.S.) sources;

general economic and political conditions in the markets in which we operate;

laws or regulations relating to non-U.S. military contracts that favor purchases from non-U.S. manufacturers over U.S. manufacturers;

the imposition of tariffs, embargoes, export controls and other trade restrictions; and

different and changing legal and regulatory requirements, including those pertaining to data protection and privacy, in the jurisdictions in which we currently operate or may operate in the future.

Negative developments in any of these areas in one or more countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, threats to our intellectual property, difficulty in collecting receivables and a higher cost of doing business, any of which could negatively impact our business, financial condition or results of operations. Moreover, our sales, including sales to customers outside the U.S., are denominated in dollars, and downward fluctuations in the value of foreign currencies relative to the U.S. dollar may make our products more expensive than other products, which could harm our business.

***Potential future acquisitions could be difficult to integrate, divert the attention of key personnel, disrupt our business, dilute stockholder value and impair our financial results.***

## Edgar Filing: AeroVironment Inc - Form 10-K

We intend to consider strategic acquisitions that would add to our customer base, technological capabilities or system offerings. Acquisitions involve numerous risks, any of which could harm our business, including the following:

difficulties in integrating the operations, technologies, products, existing contracts, accounting and personnel of the target company and realizing the anticipated synergies of the combined businesses;

Table of Contents

difficulties in supporting and transitioning customers, if any, of the target company;

diversion of financial and management resources from existing operations;

the price we pay or other resources that we devote may exceed the value we realize, or the value we could have realized if we had allocated the purchase price or other resources to another opportunity;

risks of entering new markets in which we have limited or no experience;

potential loss of key employees, customers and strategic alliances from either our current business or the target company's business;

assumption of unanticipated problems or latent liabilities, such as problems with the quality of the target company's products; and

inability to generate sufficient revenue to offset acquisition costs.

Acquisitions also frequently result in the recording of goodwill and other intangible assets which are subject to potential impairments in the future that could harm our financial results. In addition, if we finance acquisitions by issuing equity, or securities convertible into equity, then our existing stockholders may be diluted, which could lower the market price of our common stock. If we finance acquisitions through debt, then such future debt financing may contain covenants or other provisions that limit our operational or financial flexibility. As a result, if we fail to properly evaluate acquisitions or investments, then we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate. The failure to successfully evaluate and execute acquisitions or investments or otherwise adequately address these risks could materially harm our business and financial results.

***Environmental laws and regulations and unforeseen costs could impact our future earnings.***

The manufacture and sale of our products in certain states and countries may subject us to environmental and other regulations. For example, we obtain a significant number of our electronics components from companies located in East Asia, where environmental rules may be less stringent than in the United States. Over time, the countries where these companies are located may adopt more stringent environmental regulations, resulting in an increase in our manufacturing costs. Furthermore, certain environmental laws, including the U.S. Comprehensive, Environmental Response, Compensation and Liability Act of 1980, impose strict, joint and several liability on current and previous owners or operators of real property for the cost of removal or remediation of hazardous substances and impose liability for damages to natural resources. These laws often impose liability even if the owner or operator did not know of, or was not responsible for, the release of such hazardous substances. These environmental laws also assess liability on persons who arrange for hazardous substances to be sent to disposal or treatment facilities when such facilities are found to be contaminated. Such persons can be responsible for cleanup costs even if they never owned or operated the contaminated facility. Although we have not yet been named a responsible party at a contaminated site, we could be named a potentially responsible party in the future. We cannot assure you that such existing laws or future laws will not have a material adverse effect on our future earnings or results of operations.

***Our plug-in electric and hybrid vehicle charging system business is subject to federal, state and international laws regarding data protection and privacy, and a privacy breach could damage our reputation, expose us to litigation risk and adversely affect our business.***

In connection with our emerging plug-in electric and hybrid vehicle charging system business, we collect, process and retain certain sensitive and confidential customer information. As a result, we are subject to increasingly rigorous federal, state and international laws regarding privacy and data protection. Compliance with these constantly evolving laws may cause us to incur significant costs or

Table of Contents

require changes to our business practices, which could reduce our revenue. If we fail to comply with these laws, proceedings may be brought against us by governmental entities or others or penalties may be imposed on us, either of which could have a material adverse effect on our business, results of operations and financial condition. While we rely, in part, on security services and software provided by outside vendors to protect sensitive and confidential customer information, there is no guarantee that the protections that we or our outside vendors have implemented will prevent security breaches. Any actual, threatened or perceived security breach that could result in misappropriation, loss or other unauthorized disclosure of sensitive or confidential customer information could harm our reputation and relationship with customers, expose us to litigation risk and liability and adversely affect our business.

***Our business and operations are subject to the risks of earthquakes and other natural catastrophic events.***

Our corporate headquarters, research and development and manufacturing operations are located in Southern California, a region known for seismic activity and wild fires. A significant natural disaster, such as an earthquake, fire or other catastrophic event, could severely affect our ability to conduct normal business operations, and as a result, our future operating results could be materially and adversely affected.

**Risks Related to Our U.S. Government Contracts**

***We are subject to extensive government regulation, and our failure to comply with applicable regulations could subject us to penalties that may restrict our ability to conduct our business.***

As a contractor to the U.S. government, we are subject to and must comply with various government regulations that impact our revenue, operating costs, profit margins and the internal organization and operation of our business. The most significant regulations and regulatory authorities affecting our business include the following:

the Federal Acquisition Regulations and supplemental agency regulations, which comprehensively regulate the formation and administration of, and performance under, U.S. government contracts;

the Truth in Negotiations Act, which requires certification and disclosure of all factual cost and pricing data in connection with contract negotiations;

the False Claims Act and the False Statements Act, which impose penalties for payments made on the basis of false facts provided to the government and on the basis of false statements made to the government, respectively;

the Foreign Corrupt Practices Act, which prohibits U.S. companies from providing anything of value to a foreign official to help obtain, retain or direct business, or obtain any unfair advantage;

the National Telecommunications and Information Administration and the Federal Communications Commission, which regulate the wireless spectrum allocations upon which UAS depend for operation and data transmission in the U.S.;

the Federal Aviation Administration, which is in the process of drafting regulations specifically for small UAS operation in the U.S.;

the International Traffic in Arms Regulations, which regulate the export of controlled technical data, defense articles and defense services and restrict from which countries we may purchase materials and services used in the production of certain of our products; and

Table of Contents

laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

Also, we need special security clearances and regulatory approvals to continue working on certain of our projects with the U.S. government. Classified programs generally will require that we comply with various executive orders, federal laws and regulations and customer security requirements that may include restrictions on how we develop, store, protect and share information, and may require our employees to obtain government security clearances. Our failure to comply with applicable regulations, rules and approvals or misconduct by any of our employees could result in the imposition of fines and penalties, the loss of security clearances, the loss of our government contracts or our suspension or debarment from contracting with the U.S. government generally, any of which would harm our business, financial condition and results of operations. We are also subject to certain regulations of comparable government agencies in other countries, and our failure to comply with these non-U.S. regulations could also harm our business, financial condition or results of operations.

***Our business could be adversely affected by a negative audit or investigation by the U.S. government.***

U.S. government agencies, primarily the DCAA and the DCMA, routinely audit and investigate government contractors. These agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. These agencies also may review the adequacy of, and a contractor's compliance with, its internal control systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems.

Like most government contractors, our contracts are audited and reviewed on a continual basis by the DCMA and the DCAA. Audits for costs incurred on work performed after fiscal year 2005 have not yet been completed. In addition, non-audit reviews or investigations by the government may still be conducted on all of our government contracts. Any costs found to be improperly allocated to a specific contract will not be reimbursed, while such costs already reimbursed must be refunded. If an audit or investigation of our business were to uncover improper or illegal activities, then we could be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. government. We could suffer serious harm to our reputation if allegations of impropriety or illegal acts were made against us, even if the allegations were inaccurate. In addition, responding to governmental audits or investigations may involve significant expense and divert management attention. If any of the foregoing were to occur, our financial condition and operating results could be materially adversely affected.

Moreover, if any of our administrative processes and systems are found not to comply with the applicable requirements, we may be subjected to increased government scrutiny or required to obtain additional governmental approvals that could delay or otherwise adversely affect our ability to compete for or perform contracts. In February 2010 we were notified by the U.S. Department of Justice, or DOJ, that it had initiated an investigation into our billing practices with respect to our government contracts. We are currently cooperating with this investigation, which we believe may be the result of prior DCAA audit activity. An unfavorable outcome to such an audit or investigation by the DCAA, DOJ or other government agency, could materially adversely affect our competitive position, affect our ability to obtain the maximum price for our products and services, and result in a substantial reduction of our revenues.

If we were suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating results would be materially harmed.

Table of Contents

***Some of our contracts with the U.S. government allow it to use inventions developed under the contracts and to disclose technical data to third parties, which could harm our ability to compete.***

Some of our contracts allow the U.S. government to use, royalty-free, or have others use, inventions developed under those contracts on behalf of the government. Some of the contracts allow the federal government to disclose technical data without constraining the recipient on how those data are used. The ability of third parties to use patents and technical data for government purposes creates the possibility that the government could attempt to establish alternative suppliers or to negotiate with us to reduce our prices. The potential that the government may release some of the technical data without constraint creates the possibility that third parties may be able to use this data to compete with us, which could have a material adverse effect on our business, results of operations or financial condition.

***U.S. government contracts are generally not fully funded at inception and contain certain provisions that may be unfavorable to us, which could prevent us from realizing our contract backlog and materially harm our business and results of operations.***

DoD contracts typically involve long lead times for design and development, and are subject to significant changes in contract scheduling. Congress generally appropriates funds on a fiscal year basis even though a program may continue for several years. Consequently, programs are often only partially funded initially, and additional funds are committed only as Congress makes further appropriations. The termination or reduction of funding for a government program would result in a loss of anticipated future revenue attributable to that program.

The actual receipt of revenue on awards included in backlog may never occur or may change because a program schedule could change or the program could be canceled, or a contract could be reduced, modified or terminated early.

In addition, U.S. government contracts generally contain provisions permitting termination, in whole or in part, at the government's convenience or for contractor default. Since a substantial majority of our revenue is dependent on the procurement, performance and payment under our U.S. government contracts, the termination of one or more critical government contracts could have a negative impact on our results of operations and financial condition. Termination arising out of our default could expose us to liability and have a material adverse effect on our ability to re-compete for future contracts and orders. Moreover, several of our contracts with the U.S. government do not contain a limitation of liability provision, creating a risk of responsibility for indirect, incidental damages and consequential damages. These provisions could cause substantial liability for us, especially given the use to which our products may be put.

***U.S. government contracts are subject to a competitive bidding process that can consume significant resources without generating any revenue.***

U.S. government contracts are frequently awarded only after formal, protracted competitive bidding processes and, in many cases, unsuccessful bidders for U.S. government contracts are provided the opportunity to protest contract awards through various agency, administrative and judicial channels. We derive significant revenue from U.S. government contracts that were awarded through a competitive bidding process. Much of the UAS business that we expect to seek in the foreseeable future likely will be awarded through competitive bidding. Competitive bidding presents a number of risks, including the following:

the need to bid on programs in advance of the completion of their design, which may result in unforeseen technological difficulties and cost overruns;

the substantial cost and managerial time and effort that must be spent to prepare bids and proposals for contracts that may not be awarded to us;

Table of Contents

the need to estimate accurately the resources and cost structure that will be required to service any contract we are awarded;  
and

the expense and delay that may arise if our competitors protest or challenge contract awards made to us pursuant to competitive bidding, and the risk that any such protest or challenge could result in the delay of our contract performance, the distraction of management, the resubmission of bids on modified specifications, or in termination, reduction or modification of the awarded contract.

We may not be provided the opportunity to bid on contracts that are held by other companies and are scheduled to expire if the government extends the existing contract. If we are unable to win particular contracts that are awarded through a competitive bidding process, then we may not be able to operate in the market for goods and services that are provided under those contracts for a number of years. If we are unable to win new contract awards over any extended period consistently, then our business and prospects will be adversely affected.

**Risks Related to Our Intellectual Property**

***If we fail to protect, or incur significant costs in defending, our intellectual property and other proprietary rights, our business, financial condition, and results of operations could be materially harmed.***

Our success depends, in large part, on our ability to protect our intellectual property and other proprietary rights. We rely primarily on patents, trademarks, copyrights, trade secrets and unfair competition laws, as well as license agreements and other contractual provisions, to protect our intellectual property and other proprietary rights. However, a significant portion of our technology is not patented, and we may be unable or may not seek to obtain patent protection for this technology. Moreover, existing U.S. legal standards relating to the validity, enforceability and scope of protection of intellectual property rights offer only limited protection, may not provide us with any competitive advantages, and may be challenged by third parties. The laws of countries other than the United States may be even less protective of intellectual property rights. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property or otherwise gaining access to our technology. Unauthorized third parties may try to copy or reverse engineer our products or portions of our products or otherwise obtain and use our intellectual property. Moreover, many of our employees have access to our trade secrets and other intellectual property. If one or more of these employees leave us to work for one of our competitors, then they may disseminate this proprietary information, which may as a result damage our competitive position. If we fail to protect our intellectual property and other proprietary rights, then our business, results of operations or financial condition could be materially harmed.

In addition, affirmatively defending our intellectual property rights and investigating whether we are pursuing a product or service development that may violate the rights of others may entail significant expense. We have not found it necessary to resort to legal proceedings to protect our intellectual property, but may find it necessary to do so in the future. Any of our intellectual property rights may be challenged by others or invalidated through administrative processes or litigation. If we resort to legal proceedings to enforce our intellectual property rights or to determine the validity and scope of the intellectual property or other proprietary rights of others, then the proceedings could result in significant expense to us and divert the attention and efforts of our management and technical employees, even if we prevail.

***We may be sued by third parties for alleged infringement of their proprietary rights, which could be costly, time-consuming and limit our ability to use certain technologies in the future.***

We may become subject to claims that our technologies infringe upon the intellectual property or other proprietary rights of third parties. Any claims, with or without merit, could be time-consuming



Table of Contents

and expensive, and could divert our management's attention away from the execution of our business plan. Moreover, any settlement or adverse judgment resulting from these claims could require us to pay substantial amounts or obtain a license to continue to use the disputed technology, or otherwise restrict or prohibit our use of the technology. We cannot assure you that we would be able to obtain a license from the third party asserting the claim on commercially reasonable terms, if at all, that we would be able to develop alternative technology on a timely basis, if at all, or that we would be able to obtain a license to use a suitable alternative technology to permit us to continue offering, and our customers to continue using, our affected product. An adverse determination also could prevent us from offering our products to others. Infringement claims asserted against us may have a material adverse effect on our business, results of operations or financial condition.

**Risks Relating to Securities Markets and Investment in Our Stock**

*The price of our common stock may fluctuate significantly.*

The market prices for securities of emerging technology companies have historically been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. The market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot control, including the following:

U.S. government spending levels, both generally and by our particular customers;

The volume of operational activity by the U.S. military;

delays in the payment of our invoices by government payment offices, resulting in potentially reduced earnings during a particular fiscal quarter;

announcements of new products or technologies, commercial relationships or other events relating to us or our industry or our competitors;

failure of any of our key products to gain market acceptance;

variations in our quarterly operating results;

perceptions of the prospects for the markets in which we compete;

changes in general economic conditions;

changes in securities analysts' estimates of our financial performance;

regulatory developments in the U.S. and foreign countries;

fluctuations in stock market prices and trading volumes of similar companies;

## Edgar Filing: AeroVironment Inc - Form 10-K

news about the markets in which we compete or regarding our competitors;

terrorist acts or military action related to international conflicts, wars or otherwise;

sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;  
and

additions or departures of key personnel.

In addition, the equity markets in general, and NASDAQ in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Further, the market prices of securities of emerging technology companies have been particularly volatile. These broad market and industry factors may affect the market price of our common stock adversely, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action

Table of Contents

litigation often has been instituted against that company. This type of litigation, if instituted against us, could result in substantial costs and a diversion of management's attention and resources.

*Our management, whose interests may not be aligned with yours, is able to exert significant influence over all matters requiring stockholder approval.*

As of June 11, 2010, our directors, executive officers and their affiliates collectively beneficially owned 4,900,272 shares, or approximately 22%, of our total outstanding shares of common stock. Accordingly, our directors and executive officers as a group may be able to exert significant influence over matters requiring stockholder approval, including the election of directors. The interests of our directors and executive officers may not be fully aligned with yours. Although there is no agreement among our directors and executive officers with respect to the voting of their shares, this concentration of ownership may delay, defer or even prevent a change in control of our company, and make transactions more difficult or impossible without the support of all or some of our directors and executive officers. These transactions might include proxy contests, tender offers, mergers or other purchases of common stock that could give you the opportunity to realize a premium over the then-prevailing market price for shares of our common stock.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

All of our facilities are leased. Our corporate headquarters are located in Monrovia, California where we lease approximately 13,000 square feet under an agreement expiring in September 2010. We have several other leased facilities in Monrovia that house our Efficient Energy Systems business. These facilities have total square footage of approximately 71,000 and leases that expire between the end of 2010 and 2011.

Our principal UAS facilities are located in Simi Valley, California. As of April 30, 2010, we leased three facilities for our UAS segment that have total square footage of approximately 236,000 under leases that expire between 2012 and 2014. These three facilities are used for administration, research and development, logistics and manufacturing. In addition, we maintain a 21,000 square foot services facility in Huntsville, Alabama, the lease for which expires in 2014.

We additionally have a small leased office in Virginia for business development and sales as well as lease arrangements with several test flight fields in California. We believe that our current leased facilities and additional or alternative space available to us will be adequate to meet our needs for the foreseeable future.

**Item 3. Legal Proceedings.**

We are not currently a party to any material legal proceedings. We are, however, subject to lawsuits from time to time in the ordinary course of business.

**Item 4. (Removed and Reserved)**

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.****Common Stock**

The following table sets forth, for the periods indicated, the high and low sales prices for our common stock from May 1, 2008 through April 30, 2010. The following quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

	Fiscal Year Ended April 30,			
	2010		2009	
	High	Low	High	Low
First Quarter	\$ 32.90	\$ 23.15	\$ 32.98	\$ 22.82
Second Quarter	\$ 31.25	\$ 26.28	\$ 36.64	\$ 25.08
Third Quarter	\$ 35.38	\$ 25.64	\$ 40.50	\$ 28.50
Fourth Quarter	\$ 34.11	\$ 21.64	\$ 41.22	\$ 18.50

On June 11, 2010, the closing sales price of our common stock as reported on the NASDAQ Global Select Market was \$25.02 per share. As of June 11, 2010, there were 77 holders of record of our common stock.

**Dividends**

We currently intend to retain all future earnings, if any, for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. Any future determination related to dividend policy will be made at the discretion of our board of directors and will depend upon, among other factors, our results of operations, financial condition, capital requirements, contractual restrictions and such other factors as our board of directors deems relevant.

Table of Contents

**Stock Price Performance Graph**

The following graph shows a comparison of cumulative returns on our common stock, based on the market price of the common stock, with the cumulative total returns of companies in the Russell 2000 Index and the SPADES Index.

***Cumulative Total Return***

The following table shows the value of \$100 invested on January 22, 2007 in AeroVironment, Inc., the Russell 2000 Index, and the SPADES Index.

	<b>Performance Graph Table (\$)</b>				
	<b>Jan 22-07</b>	<b>Apr 30-07</b>	<b>Apr 30-08</b>	<b>Apr 30-09</b>	<b>Apr 30-10</b>
AeroVironment Stock	100	126	141	139	154
Russell 2000 Index	100	105	92	63	92
SPADES Index	100	108	112	72	102

The stock price performance shown on the graph above is not necessarily indicative of future price performance. Factual material was obtained from sources believed to be reliable, but we are not responsible for any errors or omissions contained therein. No portions of this graph shall be deemed incorporated by reference into any filing under the Securities Act, or the Exchange Act through any general statement incorporating by reference in its entirety the report in which this graph appears, except to the extent that we specifically incorporate this graph or a portion of it by reference. In addition, this graph shall not be deemed filed under either the Securities Act or the Exchange Act.

Table of Contents**Item 6. Selected Consolidated Financial Data.**

The following selected financial data should be read in conjunction with our consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included in Item 8, "Financial Statements and Supplementary Data" of this Form 10-K in order to understand fully factors that may affect the comparability of the financial data presented below.

	Year Ended April 30,				
	2010	2009	2008	2007	2006
(In thousands, except per share data)					
<b>Consolidated Income Statement Data:</b>					
Revenue	\$ 249,518	\$ 247,662	\$ 215,746	\$ 173,721	\$ 139,357
Net income	\$ 20,716	\$ 24,245	\$ 21,386	\$ 20,718	\$ 11,208
<b>Earnings per common share:</b>					
Basic	\$ 0.97	\$ 1.15	\$ 1.08	\$ 1.39	\$ 0.86
Diluted	\$ 0.94	\$ 1.11	\$ 1.00	\$ 1.22	\$ 0.75
Weighted average common shares outstanding (basic):	21,392	21,024	19,767	14,947	13,012
Weighted average common shares outstanding (diluted):	21,977	21,776	21,372	16,992	14,874
<b>Balance Sheet Data</b>					
Total assets	\$ 281,971	\$ 253,181	\$ 205,211	\$ 168,177	\$ 64,950
Long-term obligations	\$ 4,438	\$ 7,117	\$ 5,460	\$ 541	\$ 2,617

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.****Introduction**

The following discussion of our financial condition and results of operations should be read in conjunction with our "Selected Consolidated Financial Data" and our consolidated financial statements and notes thereto included herein as Item 8. This discussion contains forward-looking statements. Refer to "Forward-Looking Statements" on page 2 and "Risk Factors" beginning on page 21, for a discussion of the uncertainties, risks, and assumptions associated with these statements.

**Overview**

We design, develop, produce and support a technologically-advanced portfolio of unmanned aircraft systems, or UAS, that we supply primarily to organizations within the U.S. Department of Defense, or DoD, charging systems for electric vehicle batteries and power cycling and test systems for electric vehicles. We derive the majority of our revenue from these business areas and we believe that the markets for these solutions have significant growth potential. Additionally, we believe that some of the innovative potential products in our research and development pipeline, some of which we receive customer funding to develop, others we fund ourselves, will emerge as new growth platforms in the future, creating additional market opportunities.

The success we have achieved with our current products stems from our investment in research and development and our ability to invent and deliver advanced solutions, utilizing our proprietary technologies, to help our government and commercial customers operate more effectively and efficiently. Our core technological capabilities, developed through nearly 40 years of innovation, include lightweight aerostructures, electric propulsion systems, efficient electric energy generation and storage

Table of Contents

systems, high-density energy packaging, miniaturization, controls integration and systems engineering optimization.

Our Unmanned Aircraft Systems business segment focuses primarily on the design, development, production and support of innovative UAS that provide situational awareness to increase the security and effectiveness of our customers' operations. Our Efficient Energy Systems business segment focuses primarily on the design, development, production and support of innovative efficient electric energy systems that address the growing demand for clean transportation and clean energy solutions.

**Revenue**

We generate our revenue primarily from the sale and support of our small UAS and electric vehicle fast charge and test systems solutions. Support for our small UAS customers includes training, spare parts, product repair, product replacement, and the customer-contracted operation of our small UAS by our personnel. We refer to these support activities collectively as our services operation. We derive most of our small UAS revenue from fixed-price and cost-plus-fee contracts with the U.S. government, and most of our electric vehicle fast charge and test systems revenue from sales and service to commercial customers.

**Cost of Sales**

Cost of sales consists of direct costs and allocated indirect costs. Direct costs include labor, materials, travel, subcontracts and other costs directly related to the execution of a specific contract. Indirect costs include overhead expenses, fringe benefits and other costs that are not directly charged to a specific contract.

**Gross Margin**

Gross margin is equal to revenue minus cost of sales. We use gross margin as a financial metric to help us understand trends in our direct costs and allocated indirect costs when compared to the revenue we generate.

**Research and Development Expense**

Research and development, or R&D, is an integral part of our business model. We conduct significant internally funded research and development and anticipate that research and development expense will continue to increase in absolute dollars for the foreseeable future. Our UAS research and development activities focus specifically on creating capabilities that support our existing small UAS product portfolio as well as new UAS platforms. These activities are funded both externally by customers and internally.

**Selling, General and Administrative**

Our selling, general and administrative expenses, or SG&A, include salaries and other expenses related to selling, marketing and proposal activities, and other administrative costs. SG&A is an important financial metric that we analyze to help us evaluate the contribution of our selling, marketing and proposal activities to revenue generation.

**Other Income and Expenses**

Other income and expenses includes interest income and interest expense.

Table of Contents

**Income Tax Expense**

Our effective tax rates are substantially lower than the statutory rates primarily due to research and development tax credits.

**Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. When we prepare these consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Some of our accounting policies require that we make subjective judgments, including estimates that involve matters that are inherently uncertain. Our most critical estimates include those related to revenue recognition, inventories and reserves for excess and obsolescence, self-insured liabilities, accounting for stock-based awards, and income taxes. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting estimates affect our more significant judgments and estimates used in preparing our consolidated financial statements. See Note 1 of the Notes to Consolidated Financial Statements for our Organization and Significant Accounting Policies. There have been no material changes made to the critical accounting estimates during the periods presented in the consolidated financial statements.

**Revenue Recognition**

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management's estimates change on the basis of development of the business or market conditions.

The substantial majority of our revenue is generated pursuant to written contractual arrangements to design, develop, manufacture and/or modify complex products, and to provide related engineering, technical and other services according to customer specifications. These contracts may be fixed price or cost-reimbursable. We consider all contracts for treatment in accordance with authoritative guidance for contracts with multiple deliverables.

Revenue from product sales not under contractual arrangement is recognized at the time title and the risk and rewards of ownership pass, which typically occurs when the products are shipped and collection is reasonably assured.

Revenue and profits on fixed-price contracts are recognized using percentage-of-completion methods of accounting. Revenue and profits on fixed-price production contracts, whose units are produced and delivered in a continuous or sequential process, are recorded as units are delivered based on their selling prices, or the units-of-delivery method. Revenue and profits on other fixed-price contracts with significant engineering as well as production requirements are recorded based on the ratio of total actual incurred costs to date to the total estimated costs for each contract, or the cost-to-cost method. Under percentage-of-completion methods of accounting, a single estimated total profit margin is used to recognize profit for each contract over its entire period of performance, which can exceed one year. Accounting for revenue and profits on a fixed-price contract requires the



Table of Contents

preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work and (3) the measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. Under the units-of-delivery method, sales on a fixed-price type contract are recorded as the units are delivered during the period based on their contractual selling prices. Under the cost-to-cost method, sales on a fixed-price type contract are recorded at amounts equal to the ratio of actual cumulative costs incurred divided by total estimated costs at completion, multiplied by (A) the total estimated contract revenue, less (B) the cumulative sales recognized in prior periods. The profit recorded on a contract in any period using either the units-of-delivery method or cost-to-cost method is equal to (X) the current estimated total profit margin multiplied by the cumulative sales recognized, less (Y) the amount of cumulative profit previously recorded for the contract. In the case of a contract for which the total estimated costs exceed the total estimated revenue, a loss arises, and a provision for the entire loss is recorded in the period that it becomes evident. The unrecoverable costs on a loss contract that are expected to be incurred in future periods are recorded in the program cost.

Revenue and profits on cost-reimbursable type contracts are recognized as costs are incurred on the contract, at an amount equal to the costs plus the estimated profit on those costs. The estimated profit on a cost-reimbursable contract is generally fixed or variable based on the contractual fee arrangement.

We review cost performance and estimates to complete at least quarterly and in many cases more frequently. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur. The impact of revisions in profit estimates for all types of contracts are recognized on a cumulative catch-up basis in the period in which the revisions are made. Amounts representing contract change orders or claims are included in revenue only when they can be reliably estimated and their realization is probable. Incentives or penalties and awards applicable to performance on contracts are considered in estimating revenue and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance.

#### **Inventories and Reserve for Excess and Obsolescence**

Our policy for valuation of inventory, including the determination of obsolete or excess inventory, requires us to perform a detailed assessment of inventory at each balance sheet date, which includes a review of, among other factors, an estimate of future demand for products within specific time horizons, valuation of existing inventory, as well as product lifecycle and product development plans. Inventory reserves are also provided to cover risks arising from slow-moving items. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. We may be required to record additional inventory write-downs if actual market conditions are less favorable than those projected by our management.

#### **Self-Insured Liability**

We are self-insured for employee medical claims, subject to individual and aggregate stop-loss policies. We estimate a liability for claims filed and incurred but not reported claims based upon recent claims experience and an analysis of the average period of time between the occurrence of a claim and the time it is reported to and paid by us. We perform an annual evaluation of this policy and have determined that for all prior years during which this policy has been in effect there have been cost advantages to this policy, as compared to obtaining commercially available employee medical insurance.

# Edgar Filing: AeroVironment Inc - Form 10-K

## Table of Contents

However, actual results may differ materially from those estimated and could have a material impact on our consolidated financial statements.

### **Income Taxes**

We are required to estimate our income taxes, which includes estimating our current income taxes as well as measuring the temporary differences resulting from different treatment of items for tax and accounting purposes. We currently have significant deferred assets, which are subject to periodic recoverability assessments. Realizing our deferred tax assets principally depends on our achieving projected future taxable income. We may change our judgments regarding future profitability due to future market conditions and other factors, which may result in recording a valuation allowance against those deferred tax assets.

### **Fiscal Periods**

Our fiscal year ends on April 30. Due to our fixed year end date of April 30, our first and fourth quarters each consist of approximately 13 weeks. The second and third quarters each consist of 13 weeks. Our first three quarters end on a Saturday.

### **Results of Operations**

The following table sets forth certain historical consolidated income statement data expressed in dollars (in thousands) and as a percentage of revenue for the periods indicated. Certain amounts may not sum due to rounding.

	Fiscal Year Ended April 30,					
	2010		2009		2008	
Revenue	\$ 249,518	100%	\$ 247,662	100%	\$ 215,746	100%
Cost of sales	152,692	61%	159,065	64%	137,199	64%
Gross margin	96,826	39%	88,597	36%	78,547	36%
Selling, general and administrative	42,429	17%	34,246	14%	33,662	16%
Research and development	24,510	10%	21,798	9%	16,441	8%
Income from operations	29,887	12%	32,553	13%	28,444	13%
Interest income	195	0%	1,244	1%	3,795	2%
Income before income taxes	30,082	12%	33,797	14%	32,239	15%
Income tax expense	9,366	4%	9,552	4%	10,853	5%
Net income	\$ 20,716	8%	\$ 24,245	10%	\$ 21,386	10%

Table of Contents

The following table sets forth our revenue and gross margin generated by each operating segment for the periods indicated:

<b>Fiscal Year Ended April 30,</b>			
	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>(In thousands)</b>			
<b>Revenue:</b>			
UAS	\$ 224,179	\$ 211,364	\$ 186,615
EES	25,339	36,298	29,131
<b>Total</b>	<b>\$ 249,518</b>	<b>\$ 247,662</b>	<b>\$ 215,746</b>
<b>Gross margin:</b>			
UAS	\$ 85,157	\$ 70,968	\$ 68,598
EES	11,669	17,629	9,949
<b>Total</b>	<b>\$ 96,826</b>	<b>\$ 88,597</b>	<b>\$ 78,547</b>

**Fiscal Year Ended April 30, 2010 Compared to Fiscal Year Ended April 30, 2009**

**Revenue.** Revenue for the fiscal year ended April 30, 2010 was \$249.5 million, as compared to \$247.7 million for the fiscal year ended April 30, 2009, representing an increase of \$1.8 million, or 1%. UAS revenue increased \$12.8 million, or 6%, to \$224.2 million for the fiscal year ended April 30, 2010, primarily due to higher service revenue of \$20.9 million and increased customer-funded R&D work of \$12.0 million, partially offset by lower product deliveries of \$20.1 million. The increase in UAS service revenue was primarily due to the retrofitting of Raven B systems with our digital data link, or DDL, technology. The increase in customer-funded R&D work was primarily due to increased activity on the Global Observer program. The decrease in product deliveries was primarily due to the reduction in our analog Raven B production as we migrated into the production and retrofit of Raven B systems with our DDL technology. Efficient Energy Systems, or EES, revenue decreased \$11.0 million, or 30%, to \$25.3 million for the fiscal year ended April 30, 2010, primarily due to decreased product deliveries of our industrial electric vehicle charging systems and power cycling and test systems.

**Cost of Sales.** Cost of sales for the fiscal year ended April 30, 2010 was \$152.7 million, as compared to \$159.1 million for the fiscal year ended April 30, 2009, representing a decrease of \$6.4 million, or 4%. The decrease in cost of sales was caused by lower EES cost of sales of \$5.0 million and UAS cost of sales of \$1.4 million.

**Gross Margin.** Gross margin for the fiscal year ended April 30, 2010 was \$96.8 million, as compared to \$88.6 million for the fiscal year ended April 30, 2009, representing an increase of \$8.2 million, or 9%. As a percentage of revenue, gross margin increased from 36% to 39%. UAS gross margin increased \$14.2 million, or 20%, to \$85.2 million for the fiscal year ended April 30, 2010, primarily due to increased sales volume. As a percentage of revenue, gross margin for UAS increased from 34% to 38%, primarily due to a higher amount of fixed-price contract revenue compared to cost-reimbursable contract revenue. EES gross margin decreased \$6.0 million, or 34%, to \$11.7 million for the fiscal year ended April 30, 2010, primarily due to decreased sales volume. As a percentage of revenue, EES gross margin decreased from 49% to 46%, primarily due to a lower level of product deliveries compared to service related revenue.

**Selling, General and Administrative.** SG&A expense for the fiscal year ended April 30, 2010 was \$42.4 million, or 17% of revenue, compared to SG&A expense of \$34.2 million, or 14% of revenue, for the fiscal year ended April 30, 2009. SG&A expense increased primarily due to higher bid and proposal activity, selling and marketing expenses, and administrative costs.

Table of Contents

**Research and Development.** R&D expense for the fiscal year ended April 30, 2010 was \$24.5 million, or 10% of revenue, compared to R&D expense of \$21.8 million, or 9% of revenue, for the fiscal year ended April 30, 2009. R&D expense increased primarily due to increased investment in development initiatives for industrial electrical vehicle charging systems infrastructure.

**Interest Income.** Interest income for the fiscal year ended April 30, 2010 was \$0.2 million, as compared to interest income of \$1.2 million for the fiscal year ended April 30, 2009, representing a decrease of \$1.0 million. Interest income decreased primarily due to lower yields on investment grade securities.

**Income Tax Expense.** Our effective income tax rate was 31.1% for the fiscal year ended April 30, 2010, as compared to 28.3% for the fiscal year ended April 30, 2009. The increase was caused primarily by lower R&D tax credits in the fiscal year ended April 30, 2010.

**Fiscal Year Ended April 30, 2009 Compared to Fiscal Year Ended April 30, 2008**

**Revenue.** Revenue for the fiscal year ended April 30, 2009 was \$247.7 million, as compared to \$215.7 million for the fiscal year ended April 30, 2008, representing an increase of \$32.0 million, or 15%. UAS revenue increased \$24.8 million, or 13%, to \$211.4 million for the fiscal year ended April 30, 2009, primarily due to increased customer-funded R&D of \$29.5 million and higher product deliveries of \$7.6 million, partially offset by lower services revenue of \$12.4 million. The increase in customer-funded R&D work and product deliveries was primarily due to increased activity on the Global Observer contract and higher small UAS product deliveries, respectively. Services revenue in the prior year was higher due to the retrofit of Raven A systems to Raven B systems during that period. EES revenue increased \$7.2 million, or 25%, to \$36.3 million for the fiscal year ended April 30, 2009, primarily due to higher product deliveries.

**Cost of Sales.** Cost of sales for the fiscal year ended April 30, 2009 was \$159.1 million, as compared to \$137.2 million for the fiscal year ended April 30, 2008, representing an increase of \$21.9 million, or 16%. The increase in cost of sales was caused by higher UAS cost of sales of \$22.4 million, offset by lower EES cost of sales of \$0.5 million. The increase in UAS cost of sales was primarily due to an increase in customer-funded R&D and higher product deliveries, partially offset by lower services operations. The decrease in EES cost of sales was primarily due to lower sustaining engineering costs and lower manufacturing support costs.

**Gross Margin.** Gross margin for the fiscal year ended April 30, 2009 was \$88.6 million, as compared to \$78.5 million for the fiscal year ended April 30, 2008, representing an increase of \$10.1 million, or 13%. As a percentage of revenue, gross margin remained the same at 36%. UAS gross margin increased \$2.4 million, or 3%, to \$71.0 million for the fiscal year ended April 30, 2009, primarily due to increased sales volume, partially offset by higher program costs. As a percentage of revenue, gross margin for UAS decreased from 37% to 34%. EES gross margin increased \$7.7 million, or 77%, to \$17.6 million for the fiscal year ended April 30, 2009, primarily due to increased sales volume, operational improvements and product mix. As a percentage of revenue, EES gross margin increased from 34% to 49%.

**Selling, General and Administrative.** SG&A expense for the fiscal year ended April 30, 2009 was \$34.2 million, or 14% of revenue, compared to SG&A expense of \$33.7 million, or 16% of revenue, for the fiscal year ended April 30, 2008. SG&A expense increased primarily due to higher selling and marketing expenses.

**Research and Development.** R&D expense for the fiscal year ended April 30, 2009 was \$21.8 million, or 9% of revenue, compared to R&D expense of \$16.4 million, or 8% of revenue, for the

Table of Contents

fiscal year ended April 30, 2008. R&D expense increased primarily due to increased investment in various development initiatives for UAS.

**Interest Income.** Interest income for the fiscal year ended April 30, 2009 was \$1.2 million, as compared to interest income of \$3.8 million for the fiscal year ended April 30, 2008, representing a decrease of \$2.6 million. Interest income decreased primarily due to lower yields on investment grade securities.

**Income Tax Expense.** Our effective income tax rate was 28.3% for the fiscal year ended April 30, 2009, as compared to 33.7% for the fiscal year ended April 30, 2008. The decrease was caused primarily by higher R&D tax credits in the fiscal year ended April 30, 2009.

**Liquidity and Capital Resources**

We currently have no material cash commitments, except for normal recurring trade payables, accrued expenses and ongoing research and development costs, all of which we anticipate funding through our existing working capital and funds provided by operating activities. The majority of our purchase obligations are pursuant to funded contractual arrangements with our customers. In addition, we do not currently anticipate significant investment in property, plant and equipment, and we believe that our existing cash, cash equivalents, cash provided by operating activities and other financing sources will be sufficient to meet our anticipated working capital, capital expenditure and debt service requirements, if any, during the next twelve months. There can be no assurance, however, that our business will continue to generate cash flow at current levels. If we are unable to generate sufficient cash flow from operations, then we may be required to sell assets, reduce capital expenditures or obtain additional financing. The recent credit crisis continues to create volatility and disruption in the capital markets, severely diminished liquidity and credit availability, and increased counterparty risk. Nevertheless, we anticipate that existing sources of liquidity and cash flows from operations will be sufficient to satisfy our cash needs for the foreseeable future.

Our primary liquidity needs are for financing working capital, investing in capital expenditures, supporting product development efforts, introducing new products and enhancing existing products, and marketing acceptance and adoption of our products and services. Our future capital requirements, to a certain extent, are also subject to general conditions in or affecting the defense and electric vehicle industries and are subject to general economic, political, financial, competitive, legislative and regulatory factors that are beyond our control. Moreover, to the extent that existing cash, cash equivalents, cash from operations, and cash from short-term borrowing are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. Although we are currently not a party to any agreement or letter of intent with respect to potential investment in, or acquisitions of, businesses, services or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional equity or debt financing.

Our working capital requirements vary by contract type. On cost-plus-fee programs, we typically bill our incurred costs and fees monthly as work progresses, and therefore working capital investment is minimal. On fixed-price contracts, we typically are paid as we deliver products, and working capital is needed to fund labor and expenses incurred during the lead time from contract award until contract deliveries begin.

Table of Contents**Cash Flows**

The following table provides our cash flow data as of:

	Fiscal Year Ended April 30,		
	2010	2009	2008
	(In thousands)		
Net cash provided by operating activities	\$ 35,984	\$ 39,770	\$ 15,502
Net cash (used in) provided by investing activities	\$ (124,764)	\$ (29,480)	\$ 67,022
Net cash provided by financing activities	\$ 944	\$ 1,147	\$ 1,620

**Cash Provided by Operating Activities.** Net cash provided by operating activities for the fiscal year ended April 30, 2010 decreased by \$3.8 million to \$36.0 million, compared to net cash provided by operating activities of \$39.8 million for the fiscal year ended April 30, 2009. This decrease in net cash provided by operating activities was primarily due to higher working capital needs of \$3.6 million and lower tax benefits on exercises of stock options of \$9.0 million, partially offset by higher deferred income taxes of \$4.1 million and higher depreciation of \$3.6 million.

Net cash provided by operating activities for the fiscal year ended April 30, 2009 increased by \$24.3 million to \$39.8 million, compared to net cash provided by operating activities of \$15.5 million for the fiscal year ended April 30, 2008. This increase in net cash provided by operating activities was primarily due to lower working capital needs of \$19.5 million, higher net income of \$2.9 million, higher depreciation and amortization expense of \$1.5 million and higher tax benefits on exercises of stock options of \$1.1 million, partially offset by higher deferred income taxes of \$1.3 million.

**Cash Used in Investing Activities.** Net cash used in investing activities increased by \$95.3 million to \$124.8 million for the fiscal year ended April 30, 2010, compared to net cash used by investing activities of \$29.5 million for the fiscal year ended April 30, 2009. The increase in net cash used in investing activities was primarily due to higher net purchases of U.S. Treasury bills and municipal bonds of \$97.8 million, partially offset by lower capital expenditures of \$2.5 million. During the fiscal year ended April 30, 2010 and April 30, 2009, we used cash to purchase property and equipment totaling \$10.8 million and \$13.3 million, respectively.

Net cash used in investing activities increased by \$96.5 million to \$29.5 million for the fiscal year ended April 30, 2009, compared to net cash provided by investing activities of \$67.0 million for the fiscal year ended April 30, 2008. The increase in net cash used in investing activities was primarily due to lower net redemptions of tax exempt municipal auction rate securities of \$69.6 million, higher net purchases of U.S. Treasury bills and municipal bonds of \$21.5 million and higher capital expenditures of \$5.4 million. During the fiscal year ended April 30, 2009 and April 30, 2008, we used cash to purchase property and equipment totaling \$13.3 million and \$7.9 million, respectively.

**Cash Provided by Financing Activities.** Net cash provided by financing activities decreased by \$0.2 million to \$0.9 million for the fiscal year ended April 30, 2010, compared to \$1.1 million for the fiscal year ended April 30, 2009. The decrease was due to lower exercises of stock options.

Net cash provided by financing activities decreased by \$0.5 million to \$1.1 million for the fiscal year ended April 30, 2009, compared to \$1.6 million for the fiscal year ended April 30, 2008. The decrease is primarily due to lower transfers from restricted cash.

Table of Contents**Contractual Obligations**

The following table describes our commitments to settle contractual obligations as of April 30, 2010:

	Payments Due By Period				
	Total	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years
	(In thousands)				
Operating lease obligations	\$ 9,521	\$ 3,018	\$ 4,363	\$ 2,140	\$
Purchase obligations(1)	16,815	16,815			
<b>Total</b>	<b>\$ 26,336</b>	<b>\$ 19,833</b>	<b>\$ 4,363</b>	<b>\$ 2,140</b>	<b>\$</b>

(1)

Consists of all cancelable and non-cancelable purchase orders as of April 30, 2010.

**Off-Balance Sheet Arrangements**

As of April 30, 2010, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of the SEC's Regulation S-K.

**Inflation**

Our operations have not been, and we do not expect them to be, materially affected by inflation. Historically, we have been successful in adjusting prices to our customers to reflect changes in our material and labor costs.

**New Accounting Standards**

In June 2009, the Financial Accounting Standards Board, or FASB, issued authoritative guidance that establishes the FASB Accounting Standards Codification, or ASC, as the single source of authoritative U.S. GAAP to be applied by nongovernmental entities and modifies the U.S. GAAP hierarchy to only two levels: authoritative and non-authoritative. This guidance became effective for interim periods and fiscal years ending after September 15, 2009. We adopted the provisions of the guidance in the second quarter of fiscal 2010. The adoption did not have a material impact on our consolidated financial statements.

In October 2009, the FASB issued an accounting standards update that requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices, eliminates the use of the residual method of allocation, and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue of an arrangement with multiple deliverables. This guidance will be effective for our fiscal year beginning on May 1, 2011, however, early adoption is permitted. We do not expect this new guidance will have a material impact on our consolidated financial statements.

In January 2010, the FASB issued fair value guidance requiring new disclosures and clarification of existing disclosures for assets and liabilities that are measured at fair value on either a recurring or non-recurring basis. The guidance requires disclosure of transfer activity into and out of Level 1 and Level 2 fair value measurements and also requires more detailed disclosure about the activity within Level 3 fair value measurements. The majority of the requirements in this guidance are effective for interim and annual periods beginning after December 15, 2009. Requirements related to Level 3 disclosures are effective for interim and annual periods beginning after December 15, 2010. We do not expect that the adoption of the guidance will have a material impact on our consolidated financial statements.

Table of Contents

In February 2010, the FASB issued an accounting standards update which amends certain implementation issues related to an entity's requirement to perform and disclose subsequent events procedures. The new guidance clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued. Management must perform its assessment for both interim and annual financial reporting periods. This guidance exempts Securities & Exchange Commission filers from disclosing the date through which subsequent events have been evaluated and is effective immediately for financial statements that are issued or available to be issued.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

**Interest Rate Risk**

It is our policy not to enter into interest rate derivative financial instruments. We do not currently have any significant interest rate exposure.

**Foreign Currency Exchange Rate Risk**

Since a significant part of our sales and expenses are denominated in U.S. dollars, we have not experienced significant foreign exchange gains or losses to date, and do not expect to incur significant foreign exchange gains or losses in the future. We occasionally engage in forward contracts in foreign currencies to limit our exposure on non-U.S. dollar transactions.



Table of Contents

**Item 8. Financial Statements and Supplementary Data.**

**AeroVironment, Inc.**

**Audited Consolidated Financial Statements**

**Index to Consolidated Financial Statements and Supplementary Data**

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	<u>55</u>
<u>Consolidated Balance Sheets at April 30, 2010 and 2009</u>	<u>56</u>
<u>Consolidated Statements of Income for the Years Ended April 30, 2010, 2009 and 2008</u>	<u>57</u>
<u>Consolidated Statements of Stockholders' Equity for the Years Ended April 30, 2010, 2009 and 2008</u>	<u>58</u>
<u>Consolidated Statements of Cash Flows for the Years Ended April 30, 2010, 2009 and 2008</u>	<u>59</u>
<u>Notes to Consolidated Financial Statements</u>	<u>60</u>
<u>Quarterly Results of Operations (Unaudited)</u>	<u>79</u>
<b>Supplementary Data</b>	
<u>Financial Statement Schedule: Schedule II Valuation and Qualifying Accounts</u>	<u>80</u>

**All other schedules are omitted because they are not applicable, not required or the information required is included in the Consolidated Financial Statements, including the notes thereto.**

Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of  
AeroVironment, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of AeroVironment, Inc. and subsidiaries as of April 30, 2010 and 2009, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended April 30, 2010. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of AeroVironment, Inc. and subsidiaries at April 30, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended April 30, 2010, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, AeroVironment, Inc. and subsidiaries changed their method of accounting for uncertainty in income taxes in accordance with Financial Accounting Standards Board Interpretation No. 48 on May 1, 2007.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), AeroVironment, Inc.'s internal controls over financial reporting as of April 30, 2010, based upon criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 24, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California  
June 24, 2010

Table of Contents

**AEROVIRONMENT, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands except share data)

	April 30,	
	2010	2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 28,665	\$ 116,501
Short-term investments	135,770	21,523
Accounts receivable, net of allowance for doubtful accounts of \$745 at April 30, 2010 and \$291 at April 30, 2009	38,645	42,551
Unbilled receivables and retentions	18,710	20,070
Inventories, net	20,928	11,602
Income tax receivable		3,415
Deferred income taxes	956	3,994
Prepaid expenses and other current assets	1,921	1,718
<b>Total current assets</b>	<b>245,595</b>	<b>221,374</b>
Long-term investments	6,515	7,156
Property and equipment, net	20,025	18,218
Deferred income taxes	9,747	6,313
Other assets	89	120
<b>Total assets</b>	<b>\$ 281,971</b>	<b>\$ 253,181</b>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 20,205	\$ 23,990
Wages and related accruals	10,336	10,231
Income taxes payable	6,507	
Other current liabilities	4,473	3,686
Liability for uncertain tax positions	2,592	730
<b>Total current liabilities</b>	<b>44,113</b>	<b>38,637</b>
Deferred rent	1,268	1,463
Liability for uncertain tax positions	3,170	5,654
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.0001 par value:		
Authorized shares 10,000,000; none issued or outstanding		
Common stock, \$0.0001 par value:		
Authorized shares 100,000,000		
Issued and outstanding shares 21,732,413 shares at April 30, 2010 and 21,470,481 at April 30, 2009	2	2
Additional paid-in capital	115,602	110,102
Accumulated other comprehensive loss	(760)	(537)
Retained earnings	118,576	97,860
<b>Total stockholders' equity</b>	<b>233,420</b>	<b>207,427</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 281,971</b>	<b>\$ 253,181</b>

See accompanying notes to consolidated financial statements.



Table of Contents**AEROVIRONMENT, INC.****CONSOLIDATED STATEMENTS OF INCOME****(In thousands except share and per share data)**

	Year Ended April 30,		
	2010	2009	2008
<b>Revenue:</b>			
Product sales	\$ 103,268	\$ 136,173	\$ 123,074
Contract services	146,250	111,489	92,672
	249,518	247,662	215,746
<b>Cost of sales:</b>			
Product sales	59,266	82,427	73,424
Contract services	93,426	76,638	63,775
	152,692	159,065	137,199
Gross margin	96,826	88,597	78,547
Selling, general and administrative	42,429	34,246	33,662
Research and development	24,510	21,798	16,441
Income from operations	29,887	32,553	28,444
<b>Other income:</b>			
Interest income	195	1,244	3,795
Income before income taxes	30,082	33,797	32,239
Provision for income taxes	9,366	9,552	10,853
Net income	\$ 20,716	\$ 24,245	\$ 21,386
<b>Earnings per share data:</b>			
Basic	\$ 0.97	\$ 1.15	\$ 1.08
Diluted	\$ 0.94	\$ 1.11	\$ 1.00
<b>Weighted average shares outstanding:</b>			
Basic	21,391,795	21,023,590	19,766,881
Diluted	21,977,364	21,775,727	21,372,405

See accompanying notes to consolidated financial statements.

**AEROVIRONMENT, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(In thousands except share data)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive	Total
	Shares	Amount			Loss	
Balance at April 30, 2007	18,875,957	\$ 2	\$ 83,611	\$ 52,810	\$	\$ 136,423
Adjustment to initially apply the provisions of FIN No. 48				(581)		(581)
Stock options exercised	1,738,087		1,209			1,209
Tax benefit from exercise of stock options			10,813			10,813
Stock-based compensation			490			490
Net income				21,386		21,386
Balance at April 30, 2008	20,614,044	2	96,123	73,615		169,740
Net income				24,245		24,245
Other comprehensive loss:						
Unrealized loss on investments					(537)	(537)
Comprehensive income						23,708
Stock options exercised	690,437		1,049			1,049
Restricted stock awards	166,000					
Tax benefit from exercise of stock options			12,004			12,004
Stock-based compensation			926			926
Balance at April 30, 2009	21,470,481	2	110,102	97,860	(537)	207,427
Net income				20,716		20,716
Other comprehensive loss:						
Unrealized loss on investments					(223)	(223)
Comprehensive income						20,493
Stock options exercised	205,132		836			836
Restricted stock awards	63,000					
Restricted stock awards forfeited	(6,200)					
Tax benefit from stock-based compensation			3,010			3,010
Stock-based compensation			1,654			1,654
Balance at April 30, 2010	21,732,413	\$ 2	\$ 115,602	\$ 118,576	\$ (760)	\$ 233,420

See accompanying notes to consolidated financial statements.

Table of Contents**AEROVIRONMENT, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Year ended April 30,		
	2010	2009	2008
<b>Operating activities</b>			
Net income	\$ 20,716	\$ 24,245	\$ 21,386
Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:			
Depreciation and amortization	8,982	5,355	3,849
Provision for doubtful accounts	454	71	(71)
Deferred income taxes	(253)	(4,355)	(3,104)
Stock-based compensation	1,654	926	490
Tax benefit from exercise of stock options	2,902	11,906	10,791
Excess tax benefit from stock-based compensation	(108)	(98)	(22)
Loss on disposition of property and equipment	3	17	
Changes in operating assets and liabilities:			
Accounts receivable	3,452	(12,834)	(22,026)
Unbilled receivables and retentions	1,360	520	5,904
Inventories	(9,326)	4,321	(1,908)
Income tax receivable	3,415	(983)	(2,432)
Prepaid expenses and other assets	(172)	298	(513)
Accounts payable	(3,785)	9,910	(1,944)
Other liabilities	6,690	471	5,102
Net cash and cash equivalents provided by operating activities	35,984	39,770	15,502
<b>Investing activities</b>			
Acquisition of property and equipment	(10,792)	(13,302)	(7,928)
Net purchases of held-to-maturity investments	(114,247)	(21,523)	
Net sales of available-for-sale investments	275	5,325	74,950
Proceeds from sale of property and equipment		20	
Net cash and cash equivalents (used in) provided by investing activities	(124,764)	(29,480)	67,022
<b>Financing activities</b>			
Transfer from restricted cash			389
Excess tax benefit from stock-based compensation	108	98	22
Exercise of stock options	836	1,049	1,209
Net cash and cash equivalents provided by financing activities	944	1,147	1,620
Net (decrease) increase in cash and cash equivalents	(87,836)	11,437	84,144
Cash and cash equivalents at beginning of year	116,501	105,064	20,920

Cash and cash equivalents at end of year	\$	28,665	\$	116,501	\$	105,064
--	----	--------	----	---------	----	---------

**Supplemental disclosures of cash flow information**

Cash paid during the year for:

Income taxes	\$	104	\$	2,781	\$	4,484
--------------	----	-----	----	-------	----	-------

**Non-cash investing activities**

Unrealized losses on long-term investments recorded in other comprehensive income, net of deferred tax benefit of \$143 and \$357, respectively

	\$	223	\$	537
--	----	-----	----	-----

See accompanying notes to consolidated financial statements.



Table of Contents

**AEROVIRONMENT, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1. Organization and Significant Accounting Policies**

**Organization**

AeroVironment, Inc., a Delaware corporation, is engaged in the design, development, production and support of unmanned aircraft systems and efficient energy systems for various industries and governmental agencies.

**Significant Accounting Policies**

**Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of AeroVironment, Inc. and its wholly-owned subsidiaries: AV S.r.l., Skytower, LLC, AV GmbH, Skytower Inc., AILC, Inc. and Regenerative Fuel Cell Systems, LLC (collectively referred to herein as the "Company"). All intercompany balances and transactions have been eliminated in consolidation.

**Segments**

The Company's products are sold and divided among two reportable segments to reflect the Company's strategic goals. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker ("CODM") in deciding how to allocate resources and in assessing performance. The Company's CODM is the Chief Executive Officer, who reviews the revenue and gross margin results for each of these segments in order to make resource allocation decisions, including the focus of research and development, or R&D, activities, and assessing performance. The Company's reportable segments are business units that offer different products and services and are managed separately.

**Use of Estimates**

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates made by management include, but are not limited to, valuation of: inventory, deferred tax assets and liabilities, useful lives of property, plant and equipment, medical and dental liabilities, and estimates of anticipated contract costs and revenue utilized in the revenue recognition process. Actual results could differ from those estimates.

**Reclassifications**

Certain prior year amounts have been reclassified to conform to the current year presentation.

**Cash Equivalents**

The Company considers all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents. The Company's cash equivalents are comprised of money market funds, certificates of deposit of major financial institutions, and U.S. Treasury bills.

Table of Contents

**AEROVIRONMENT, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Investments**

The Company's investments are accounted for as held-to-maturity and available-for-sale and reported at amortized cost and fair value, respectively.

Unrealized gains and losses are excluded from earnings and reported as a separate component of stockholders' equity, net of deferred income taxes for available-for-sale investments.

Gains and losses realized on the disposition of investment securities are determined on the specific identification basis and credited or charged to income. Premium and discount on investments are amortized and accreted using the interest method and charged or credited to investment income.

Management determines the appropriate classification of securities at the time of purchase and re-evaluates such designation as of each balance sheet date.

Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. On a quarterly basis, the Company considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, the Company evaluates, among other factors, general market conditions, the duration and extent to which the fair value is less than cost, and our intent and ability to hold the investment to maturity. The Company also considers potential adverse conditions related to the financial health of the issuer based on rating agency actions. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in earnings and a new cost basis in the investment is established.

**Fair Values of Financial Instruments**

Fair values of cash and cash equivalents, accounts receivable, unbilled receivables, retentions and accounts payable approximate cost due to the short period of time to maturity.

**Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash, cash equivalents, U.S. Treasury bills and accounts receivable. The Company currently invests the majority of its cash in U.S. Treasury bills. The Company's revenue and accounts receivable are with a limited number of corporations and governmental entities. In the aggregate, 80%, 78% and 80% of the Company's revenue came from agencies of the U.S. government for the years ended April 30, 2010, 2009 and 2008, respectively. These agencies accounted for 58% and 63% of the accounts receivable balances at April 30, 2010 and 2009, respectively. One such agency, the U.S. Army, accounted for 44%, 43% and 62% of the Company's consolidated revenue for the years ended April 30, 2010, 2009 and 2008, respectively. The U.S. Army accounted for approximately 48%, 51% and 71% of UAS reportable segment sales for the years ended April 30, 2010, 2009 and 2008, respectively. The Company performs ongoing credit evaluations of its commercial customers and maintains an allowance for potential losses.

**Accounts Receivable, Unbilled Receivables and Retentions**

Accounts receivable represents primarily U.S. government, and to a lesser extent commercial receivables, net of allowances for doubtful accounts. Unbilled receivables represent costs in excess of billings on incomplete contracts and, where applicable, accrued profit related to government long-term contracts on which revenue has been recognized, but for which the customer has not yet been billed.

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Retentions represent amounts withheld by customers until contract completion. The Company determines the allowance for doubtful accounts based on historical customer experience and other currently available evidence. When a specific account is deemed uncollectible, the account is written off against the allowance. The allowance for doubtful accounts reflects the Company's best estimate of probable losses inherent in the accounts receivable balance; such losses have been within management's expectations. An account is deemed past due based on contractual terms rather than on how recently payments have been received.

**Inventories**

Inventories are stated at the lower of cost (using the weighted average costing method) or market value. Inventory write-offs and write-down provisions are provided to cover risks arising from slow-moving items or technological obsolescence and for market prices lower than cost. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on this evaluation, provisions are made to write inventory down to its market value.

**Long-Lived Assets**

Property and equipment are carried at cost. Depreciation of property and equipment, including amortization of leasehold improvements, are provided using the straight-line method over the following estimated useful lives:

Machinery and equipment	2 to 7 years
Computer equipment and software	2 to 5 years
Furniture and fixtures	3 to 7 years
Leasehold improvements	Lesser of useful life or term of lease

Maintenance, repairs and minor renewals are charged directly to expense as incurred. Additions and betterments to property and equipment are capitalized at cost. When the Company disposes of assets, the applicable costs and accumulated depreciation and amortization thereon are removed from the accounts and any resulting gain or loss is included in selling, general and administrative expense in the period incurred.

The Company reviews the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance, and may differ from actual cash flows. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made. At April 30, 2010 and 2009, no indicators of impairment were identified and no impairment charge was recorded.

**Product Warranty**

The Company accrues an estimate of its exposure to warranty claims based upon both current and historical product sales data and warranty costs incurred. Product warranty reserves are recorded in other current liabilities.

Table of Contents

**AEROVIRONMENT, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Self-Insurance Liability**

The Company is self-insured for employee medical claims, subject to individual and aggregate stop-loss policies. The Company estimates a liability for claims filed and incurred but not reported based upon recent claims experience and an analysis of the average period of time between the occurrence of a claim and the time it is reported to and paid by the Company. As of April 30, 2010 and 2009, the Company estimated and recorded a self insurance liability in wages and related accruals of approximately \$1,014,000 and \$680,000, respectively.

**Income Taxes**

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and income tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. The provision for income taxes reflects the taxes to be paid for the period and the change during the period in the deferred income tax assets and liabilities. The Company records a valuation allowance to reduce the deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. On May 1, 2007, the Company adopted authoritative guidance that clarifies the accounting for uncertainty in income tax recognized in an entity's financial statements which requires companies to determine whether it is "more likely than not" that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. For those tax positions where it is "not more likely than not" that a tax benefit will be sustained, no tax benefit is recognized. Where applicable, associated interest and penalties are also recorded.

**Customer Advances and Amounts in Excess of Cost Incurred**

The Company receives advances, performance-based payments and progress payments from customers that may exceed costs incurred on certain contracts, including contracts with agencies of the U.S. government. These advances are classified as advances from customers and will be offset against billings.

**Revenue Recognition**

The substantial majority of the Company's revenue is generated pursuant to written contractual arrangements to design, develop, manufacture and/or modify complex products, and to provide related engineering, technical and other services according to the specifications of the buyers (customers). These contracts may be fixed price or cost-reimbursable. The Company considers all contracts for treatment in accordance with authoritative guidance for contracts with multiple deliverables.

Revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables have value to the customer on a stand-alone basis; there is objective and reliable evidence of the fair value of the undelivered item(s); and, if the arrangement includes a general right of return, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the vendor. The Company occasionally enters into arrangements that consist of installation and repair contracts associated with hardware sold by the Company. Such arrangements consist of separate contractual arrangements and are divided into separate units of accounting where the delivered item has value to the customer on a stand-alone basis and there is objective and reasonable evidence of the fair value of the installation contract. Consideration is allocated among the separate units of accounting based on their relative fair values.

Table of Contents

**AEROVIRONMENT, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Product sales revenue is composed of revenue recognized on contracts for the delivery of production hardware and related activities. Contract services revenue is composed of revenue recognized on contracts for the provision of services, including repairs, training, engineering design, development and prototyping activities.

Revenue from cost-plus-fee contracts are recognized on the basis of costs incurred during the period plus the fee earned. Revenue from fixed-price contracts are recognized on the percentage-of-completion method. Contract costs include all direct material and labor costs and those indirect costs related to contract performance. Unbilled receivables represent costs incurred and related profit on contracts not yet billed to customers, and are invoiced in subsequent periods.

Product sales revenue is recognized on the percentage-of-completion method or upon transfer of title to the customer, which is generally upon shipment. Shipping and handling costs incurred are included in cost of sales.

Revenue and profits on fixed-price production contracts, where units are produced and delivered in a continuous or sequential process, are recorded as units are delivered based on their selling prices (the "units-of-delivery method"). Revenue and profits on other fixed-price contracts with significant engineering as well as production requirements are recorded based on the ratio of total actual incurred costs to date to the total estimated costs for each contract (the "cost-to-cost method"). Accounting for revenue and profits on a fixed-price contract requires the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work and (3) the measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. Under the units-of-delivery method, sales on a fixed-price type contract are recorded as the units are delivered during the period based on their contractual selling prices. Under the cost-to-cost method, sales on a fixed-price type contract are recorded at amounts equal to the ratio of actual cumulative costs incurred divided by total estimated costs at completion, multiplied by (i) the total estimated contract revenue, less (ii) the cumulative sales recognized in prior periods. The profit recorded on a contract in any period using either the units-of-delivery method or cost-to-cost method is equal to (i) the current estimated total profit margin multiplied by the cumulative sales recognized, less (ii) the amount of cumulative profit previously recorded for the contract. In the case of a contract for which the total estimated costs exceed the total estimated revenue, a loss arises, and a provision for the entire loss is recorded in the period that it becomes evident. The unrecoverable costs on a loss contract that are expected to be incurred in future periods are recorded in the program cost.

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management's estimates change on the basis of development of the business, market conditions or other factors. Management judgments and estimates have been applied consistently and have been reliable historically.

**Stock-Based Compensation**

Stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is generally the vesting period of the respective award. No compensation cost is ultimately recognized for awards for which employees do not render the requisite service and are forfeited.

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Research and Development**

Internally funded research and development costs, or IRAD, sponsored by the Company relate to both U.S. government products and services and those for commercial and foreign customers. IRAD costs for the Company's businesses that are U.S. government contractors are recoverable indirect contract costs that are allocated to the U.S. government contracts in accordance with U.S. government procurement regulations.

Customer-funded research and development costs are incurred pursuant to contracts (revenue arrangements) to perform research and development activities according to customer specifications. These costs are direct contract costs and are expensed to cost of sales when the corresponding revenue is recognized, which is generally as the research and development services are performed. Revenues from customer-funded research and development were approximately \$80,552,000, \$66,321,000 and \$28,280,000 for the years ended April 30, 2010, 2009 and 2008, respectively. The related costs of sales for customer-funded research and development totaled approximately \$56,532,000, \$46,493,000 and \$19,631,000 for the years ended April 30, 2010, 2009 and 2008, respectively.

**Lease Accounting**

The Company accounts for its leases and subsequent amendments as operating leases or capital leases for financial reporting purposes. Certain operating leases contain rent escalation clauses, which are recorded on a straight-line basis over the initial term of the lease with the difference between the rent paid and the straight-line rent recorded as a deferred rent liability. Lease incentives received from landlords are recorded as deferred rent liabilities and are amortized on a straight-line basis over the lease term as a reduction to rent expense. Deferred rent liabilities were approximately \$1,268,000 and \$1,463,000 as of April 30, 2010 and 2009, respectively.

**Advertising Costs**

Advertising costs consist of tradeshows and other marketing activities, and are expensed as incurred. Advertising expenses included in selling, general and administrative expenses were approximately \$994,000, \$549,000 and \$426,000 for the years ended April 30, 2010, 2009 and 2008, respectively.

**Earnings Per Share**

Basic earnings per share are computed using the weighted-average number of common shares outstanding and excludes any anti-dilutive effects of options and restricted stock. The dilutive effect of potential common shares outstanding is included in diluted earnings per share.

The reconciliation of diluted to basic shares is as follows:

	Year Ended April 30,		
	2010	2009	2008
Numerator for basic earnings per share:			
Net income	\$ 20,716,000	\$ 24,245,000	\$ 21,386,000
Denominator for basic earnings per share:			
Weighted average common shares	21,391,795	21,023,590	19,766,881
Dilutive effect of employee stock options and restricted stock	585,569	752,137	1,605,524
Denominator for diluted earnings per share	21,977,364	21,775,727	21,372,405

Table of Contents

**AEROVIRONMENT, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During the years ended April 30, 2010, 2009 and 2008, certain options and shares of restricted stock were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive. The number of options and restricted stock which met this anti-dilutive criterion was approximately 70,000, 104,000 and 379,000 for the years ended April 30, 2010, 2009 and 2008, respectively.

**Recently Issued Accounting Standards**

In June 2009, the Financial Accounting Standards Board ("FASB") issued authoritative guidance that establishes the FASB Accounting Standards Codification ("ASC") as the single source of authoritative U.S. GAAP to be applied by nongovernmental entities and modifies the U.S. GAAP hierarchy to only two levels: authoritative and non-authoritative. This guidance became effective for interim periods and fiscal years ending after September 15, 2009. The Company adopted the provisions of the guidance in the second quarter of fiscal 2010. The adoption did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued an accounting standards update that requires an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices, eliminates the use of the residual method of allocation, and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue of an arrangement with multiple deliverables. This guidance will be effective for the Company beginning on May 1, 2011, however, early adoption is permitted. The Company does not expect this new guidance will have a material impact on its consolidated financial statements.

In January 2010, the FASB issued fair value guidance requiring new disclosures and clarification of existing disclosures for assets and liabilities that are measured at fair value on either a recurring or non-recurring basis. The guidance requires disclosure of transfer activity into and out of Level 1 and Level 2 fair value measurements and also requires more detailed disclosure about the activity within Level 3 fair value measurements. The majority of the requirements in this guidance are effective for interim and annual periods beginning after December 15, 2009. Requirements related to Level 3 disclosures are effective for interim and annual periods beginning after December 15, 2010. The Company does not expect that the adoption of the guidance will have a material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued an accounting standards update which amends certain implementation issues related to an entity's requirement to perform and disclose subsequent events procedures. The new guidance clarifies that management must evaluate, as of each reporting period, events or transactions that occur after the balance sheet date through the date that the financial statements are issued. Management must perform its assessment for both interim and annual financial reporting periods. This guidance exempts SEC filers from disclosing the date through which subsequent events have been evaluated and is effective immediately for financial statements that are issued or available to be issued.

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. Investments**

Investments consist of the following:

	April 30,	
	2010	2009
(In thousands)		
Short-term investments:		
Held-to-maturity securities:		
Pre-refunded municipal bond	\$	\$ 2,029
U.S. Treasury bills	135,770	19,494
<b>Total short-term investments</b>	<b>\$ 135,770</b>	<b>\$ 21,523</b>
Long-term investments:		
Available-for-sale securities:		
Auction rate securities	\$ 6,515	\$ 7,156
<b>Total long-term investments</b>	<b>\$ 6,515</b>	<b>\$ 7,156</b>

**Held-To-Maturity Securities**

As of April 30, 2010 and 2009, the balance of held-to-maturity securities consisted of a pre-refunded municipal bond and U.S. Treasury bills. Pre-refunded municipal bonds are created when municipalities issue new debt to refinance debt issued when interest rates were higher. Once the refinancing is completed, the issuer uses the proceeds to purchase U.S. Treasury securities or state and local government securities and places these securities in an escrow account. These proceeds are then used to pay interest and principal on the original debt until the bond is called. Interest earned from these investments is recorded in interest income.

The amortized cost, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of April 30, is as follows (in thousands):

	2010				2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Pre-refunded municipal bond	\$	\$	\$	\$	\$ 2,029	\$ 5	\$	\$ 2,034
U.S. Treasury bills	135,770	5	(3)	135,772	19,494	5	19,499	19,499
<b>Total held-to-maturity investments</b>	<b>\$ 135,770</b>	<b>\$ 5</b>	<b>\$ (3)</b>	<b>\$ 135,772</b>	<b>\$ 21,523</b>	<b>\$ 10</b>	<b>\$</b>	<b>\$ 21,533</b>

The amortized cost and fair value of the Company's held-to-maturity securities by contractual maturity at April 30, 2010, are as follows:

	Cost	Fair Value
Due within one year	\$ 135,770	\$ 135,772
<b>Total</b>	<b>\$ 135,770</b>	<b>\$ 135,772</b>





Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Available-For-Sale Securities**

As of April 30, 2010 and 2009, the entire balance of available-for-sale securities consisted of four investment grade auction rate municipal bonds with maturities ranging from 9 to 24 years. These investments have characteristics similar to short-term investments, because at pre-determined intervals, generally ranging from 30 to 35 days, there is a new auction process at which the interest rates for these securities are reset to current interest rates. At the end of such period, the Company chooses to roll-over its holdings or redeem the investments for cash. A market maker facilitates the redemption of the securities and the underlying issuers are not required to redeem the investment within 365 days. Interest earned from these investments is recorded in interest income.

During the fourth quarter of the fiscal year ended April 30, 2008, the Company began experiencing failed auctions on some of its auction rate securities. A failed auction occurs when a buyer for the securities cannot be obtained and the market maker does not buy the security for its own account. The Company continues to earn interest on the investments that failed to settle at auction, at the maximum contractual rate until the next auction occurs. In the event the Company needs to access funds invested in these auction rate securities, the Company may not be able to liquidate these securities at the fair value recorded on April 30, 2010 until a future auction of these securities is successful or a buyer is found outside of the auction process.

As a result of the failed auctions, the fair values of these securities are estimated utilizing a discounted cash flow analysis as of April 30, 2010 and 2009. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction.

Based on the Company's ability to access its cash and cash equivalents, expected operating cash flows, and other sources of cash, the Company does not anticipate the current lack of liquidity on these investments will affect its ability to operate the business in the ordinary course. The Company believes the current lack of liquidity of these investments is temporary and expects that the securities will be redeemed or refinanced at some point in the future. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible impairment if a decline in fair value occurs. The auction rate securities have been in an unrealized loss position for more than 12 months. The Company has the ability and the intent to hold these investments until a recovery of fair value, which may be maturity and as of April 30, 2010, it did not consider these investments to be other-than-temporarily impaired.

The amortized cost, gross unrealized losses, and estimated fair value of the available-for-sale investments is as follows (in thousands):

	April 30,	
	2010	2009
<b>Auction rate securities</b>		
Amortized cost	\$ 7,775	\$ 8,050
Gross unrealized gains		
Gross unrealized losses	(1,260)	(894)
Fair value	\$ 6,515	\$ 7,156

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The amortized cost and fair value of the Company's auction rate securities by contractual maturity at April 30, 2010 are as follows (in thousands):

	<b>Cost</b>	<b>Fair Value</b>
Due after five through 10 years	\$ 1,450	\$ 1,242
Due after 10 years	6,325	5,273
<b>Total</b>	<b>\$ 7,775</b>	<b>\$ 6,515</b>

**3. Fair Value Measurements**

Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy contains three levels as follows:

Level 1 Inputs to the valuation based upon quoted prices (unadjusted) for identical assets or liabilities in active markets that are accessible as of the measurement date.

Level 2 Inputs to the valuation include quoted prices in either markets that are not active, or in active markets for similar assets or liabilities, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data.

Level 3 Inputs to the valuation that are unobservable inputs for the asset or liability.

The Company's financial assets measured at fair value on a recurring basis at April 30, 2010, were as follows (in thousands):

<b>Description</b>	<b>Fair Value Measurement Using Significant</b>			<b>Total</b>
	<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>	
Cash and cash equivalents	\$ 28,665	\$	\$	\$ 28,665
Auction rate securities			6,515	6,515
<b>Total</b>	<b>\$ 28,665</b>	<b>\$</b>	<b>\$ 6,515</b>	<b>\$ 35,180</b>

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis in the table above that used significant unobservable inputs (Level 3) (in thousands):

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Securities	
Balance at May 1, 2009	\$	7,156
Transfers to Level 3		
Total losses (realized or unrealized)		
Included in earnings		
Included in other comprehensive income		(366)
Purchases, issuances and settlements, net		(275)
Balance at April 30, 2010	\$	6,515

The amount of total gains or (losses) for the period included in earnings (or change in net assets) attributable to the change in unrealized gains or losses relating to assets still held at April 30, 2010

\$

The auction rate securities are valued using a discounted cash flow model. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction.

**4. Inventories, net**

Inventories consist of the following:

	April 30,	
	2010	2009
	(In thousands)	
Raw materials	\$ 6,629	\$ 6,055
Work in process	6,336	2,351
Finished goods	9,154	4,585
Inventories, gross	22,119	12,991
Reserve for inventory obsolescence	(1,191)	(1,389)
Inventories, net	\$ 20,928	\$ 11,602

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Property and Equipment, net**

Property and equipment consist of the following:

	April 30,	
	2010	2009
	(In thousands)	
Leasehold improvements	\$ 7,804	\$ 6,709
Machinery and equipment	25,512	18,183
Furniture and fixtures	2,164	2,047
Computer equipment and software	7,197	6,012
Construction in process	2,347	1,961
Property and equipment, gross	45,024	34,912
Less accumulated depreciation and amortization	(24,999)	(16,694)
Property and equipment, net	\$ 20,025	\$ 18,218

**6. Warranty Reserves**

Warranty reserve activity is summarized as follows:

	April 30,	
	2010	2009
	(In thousands)	
Beginning balance	\$ 523	\$ 344
Warranty expense	1,512	1,182
Warranty costs incurred	(1,231)	(1,003)
Ending balance	\$ 804	\$ 523

**7. Employee Savings Plan**

The Company has an employee 401(k) savings plan covering all eligible employees. The Company expensed approximately \$1,995,000, \$1,790,000 and \$1,392,000 in contributions to the plan for the years ended April 30, 2010, 2009 and 2008, respectively.

**8. Stock-Based Compensation**

For the years ended April 30, 2010, 2009 and 2008, the Company recorded stock-based compensation expense of approximately \$1,654,000, \$926,000 and \$490,000, respectively.

On January 14, 2007, the stockholders of the Company approved the 2006 Equity Incentive Plan, or 2006 Plan, effective January 21, 2007, for officers, directors, key employees and consultants. Under the 2006 Plan, incentive stock options, nonqualified stock options, restricted stock awards, stock appreciation right awards, performance share awards, performance stock unit awards, dividend equivalents awards, stock payment awards, deferred stock awards, restricted stock unit awards, other stock-based awards, performance bonus awards or performance-based awards may be granted at the discretion of a committee, which consists of outside directors. A maximum of 3,684,157 shares of stock may be issued pursuant to awards under the 2006 Plan. The maximum number of shares of common stock with respect to one or more awards that may be granted to any one participant during any twelve month period is 950,000. A maximum of \$9,500,000 may be paid in cash as a performance-based award.



Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The exercise price for any incentive stock option shall not be less than 100% of the fair market value on the date of grant. Vesting of awards is established at the time of grant.

The Company had an equity incentive plan, or 2002 Plan, for officers, directors and key employees. Under the 2002 Plan, incentive stock options or nonqualified stock options were granted, as determined by the administrator at the time of grant. Stock purchase rights were also granted under the 2002 Plan. Options under the 2002 Plan were granted at their fair market value (as determined by the board of directors). The options become exercisable at various times over a five-year period from the grant date. The 2002 Plan was terminated on the effective date of the 2006 Plan. Awards outstanding under the 2002 Plan remain outstanding and exercisable; no additional awards may be made under the 2002 Plan.

The Company had a 1992 nonqualified stock option plan, or 1992 Plan, for certain officers and key employees. Options under the 1992 Plan were granted at their fair market value (as determined by the board of directors) at the date of grant and became exercisable at various times over a five-year period from the grant date. The 1992 Plan expired in August 2002.

The Company had a 1994 nonqualified stock option plan, or 1994 Directors' Plan, for the directors of the Company. Options under the 1994 Directors' Plan were granted at their fair market value (as determined by the board of directors) at the date of grant and became exercisable on the date of grant. The 1994 Directors' Plan expired in June 2004.

The fair value of stock options granted was estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions for the years ended April 30, 2010, 2009 and 2008:

	<b>Year Ended April 30,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
Expected term (in years)	5.00	5.84	6.50
Expected volatility	24.16%	20.83%	19.50%
Risk-free interest rate	2.43%	2.33%	4.60%
Expected dividend			
Weighted average fair value at grant date	\$ 6.44	\$ 6.66	\$ 7.49

The expected term of stock options represents the weighted average period the Company expects the stock options to remain outstanding, based on the Company's historical exercise and post-vesting cancellation experience and the remaining contractual life of its outstanding options.

The expected volatility is based on peer group volatility in the absence of historical market data for the Company's stock. The peer group volatility was derived based on historical volatility of a comparable peer group index consisting of companies operating in a similar industry.

The risk free interest rate is based on the implied yield on a U.S. Treasury zero-coupon bond with a remaining term that approximates the expected term of the option.

The expected dividend yield of zero reflects that the Company has not paid any cash dividends since inception and does not anticipate paying cash dividends in the foreseeable future.

Table of Contents

**AEROVIRONMENT, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Information related to the stock option plans at April 30, 2010, 2009 and 2008, and for the years then ended is as follows:

	2006 Plan		2002 Plan		1994 Directors' Plan		1992 Plan	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at April 30, 2007		\$	1,532,423	\$ 1.95	35,189	\$ 0.59	1,941,706	\$ 0.55
Options granted	386,310	21.90						
Options exercised			(388,087)	1.12	(35,189)	0.59	(1,314,811)	0.58
Options canceled	(7,000)	24.09	(66,859)	2.76				
Outstanding at April 30, 2008	379,310	21.86	1,077,477	2.20			626,895	0.49
Options granted	160,000	25.34						
Options exercised	(20,100)	21.35	(445,606)	1.13			(224,731)	0.51
Options canceled	(22,000)	22.27	(48,563)	2.66				
Outstanding at April 30, 2009	497,210	22.98	583,308	2.97			402,164	0.48
Options granted	75,000	24.68						
Options exercised	(18,800)	20.76	(171,169)	2.55			(15,164)	0.59
Options canceled	(60,200)	22.71	(7,038)	5.99				
Outstanding at April 30, 2010	493,210	\$ 23.36	405,101	\$ 3.10			387,000	\$ 0.48
Options exercisable at April 30, 2010	145,324	\$ 22.87	312,201	\$ 2.23	\$	\$	387,000	\$ 0.48

The total intrinsic value of all options exercised during the years ended April 30, 2010, 2009 and 2008 was approximately \$5,581,000, \$21,177,000, and \$35,874,000. The intrinsic value of all options outstanding at April 30, 2010 and 2009 was \$21,046,000 and \$22,218,000, respectively. The intrinsic value of all exercisable options at April 30, 2010 and 2009, was \$17,971,000 and \$16,921,000, respectively.

A summary of the status of the Company's non-vested stock options as of April 30, 2010 and the year then ended is as follows:

Non-vested Options	Shares	Weighted Average Grant Date
--------------------	--------	-----------------------------



## Edgar Filing: AeroVironment Inc - Form 10-K

			<b>Fair Value</b>
Non-vested at April 30, 2009	678,871	\$	6.82
Granted	75,000		6.44
Cancelled	(67,238)		6.94
Vested	(245,847)		6.66

Non-vested at April 30, 2010      440,786    \$      6.78

As of April 30, 2010, there was approximately \$5,743,000 of total unrecognized compensation cost related to non-vested share-based compensation awards granted under the equity plans. That cost is expected to be recognized over an approximately five-year period or a weighted average period of approximately four years.

Table of Contents

**AEROVIRONMENT, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The weighted average fair value of options issued for the years ended April 30, 2010, 2009 and 2008 was \$6.44, \$6.66 and \$7.49, respectively. The total fair value of shares vesting during the years ended April 30, 2010, 2009 and 2008 was \$780,000, \$637,000 and \$94,000, respectively.

Proceeds from all option exercises under all stock option plans for the years ended April 30, 2010, 2009 and 2008 were approximately \$836,000, \$1,049,000 and \$1,209,000, respectively. The tax benefit realized from stock-based compensation during the years ended April 30, 2010, 2009 and 2008 was approximately \$3,010,000, \$12,004,000, and \$10,813,000, respectively.

The following tabulation summarizes certain information concerning outstanding and exercisable options at April 30, 2010:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	As of April 30, 2010	Weighted Average Remaining Contractual Life In Years	Weighted Average Exercise Price	As of April 30, 2010	Weighted Average Exercise Price	
\$ 0.37	197,595	3.49	\$ 0.37	197,595	\$ 0.37	
0.59	189,405	9.54	0.59	189,405	0.59	
0.64-0.78	207,715	3.15	0.73	207,715	0.73	
2.13	126,698	5.47	2.13	71,096	2.13	
11.79	70,688	6.17	11.79	33,390	11.79	
19.76-24.09	431,210	7.96	22.13	134,324	22.11	
31.15-32.19	62,000	8.49	31.94	11,000	32.19	
\$ 0.37-32.19	1,285,311	6.41	\$ 10.08	844,525	\$ 4.98	

The remaining weighted average contractual life of exercisable options at April 30, 2010 was 5.77 years.

Information related to the Company's restricted stock awards at April 30, 2010 and for the year then ended is as follows:

	2006 Plan	
	Shares	Weighted Average Grant Date Fair Value
Unvested stock at April 30, 2009	166,000	\$ 24.18
Stock granted	63,000	25.04
Stock vested	(32,200)	24.25
Stock canceled	(6,200)	26.90
Unvested stock at April 30, 2010	190,600	\$ 24.36

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. Income Taxes**

A reconciliation of income tax expense computed using the U.S. federal statutory rates to actual income tax expense is as follows:

	Year Ended April 30,		
	2010	2009	2008
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal benefit	1.9	2.2	3.8
R&D credits	(2.3)	(7.6)	(2.1)
Other	(3.5)	(1.3)	(3.0)
<b>Effective income tax rate</b>	<b>31.1%</b>	<b>28.3%</b>	<b>33.7%</b>

The components of the provision for income taxes are as follows (in thousands):

	Year ended April 30,		
	2010	2009	2008
<b>Current:</b>			
Federal	\$ 8,663	\$ 13,793	\$ 11,382
State	1,229	471	2,575
	9,892	14,264	13,957
<b>Deferred:</b>			
Federal	492	(2,105)	(2,394)
State	(900)	(2,600)	(710)
Foreign	(105)		
	(513)	(4,705)	(3,104)
Change in valuation allowance	(13)	(7)	
<b>Total income tax expense</b>	<b>\$ 9,366</b>	<b>\$ 9,552</b>	<b>\$ 10,853</b>

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Significant components of the Company's deferred income tax assets are as follows (in thousands):

	April 30,	
	2010	2009
Deferred income tax assets:		
Book over tax depreciation	\$ 567	\$
Accrued expenses	4,991	4,468
Allowances, reserves, and other	1,330	1,072
Capital loss and credit carry-forwards	3,357	4,925
Unrealized loss on securities	521	381
	10,766	10,846
Less: valuation allowance	(63)	(76)
Total deferred income tax assets, net	10,703	10,770
Deferred income tax liabilities:		
Tax over book depreciation		(463)
Total deferred income tax liabilities		(463)
Net deferred tax assets	\$ 10,703	\$ 10,307

At April 30, 2010 and 2009, the Company had approximately \$5,052,000 and \$5,663,000, respectively, of unrecognized tax benefits all of which would impact the Company's effective tax rate if recognized. The Company estimates that \$2,021,000 of its unrecognized tax benefits will decrease in the next twelve months due to statute of limitation expiration.

The following table summarizes the activity related to our gross unrecognized tax benefits for the years ended April 30, 2010 and 2009 (in thousands):

	April 30,	
	2010	2009
Balance as of May 1	\$ 5,663	\$ 5,784
Increases related to prior year tax positions	123	619
Decreases related to prior year tax positions	(406)	(491)
Increases related to current year tax positions	927	1,028
Decreases related to lapsing of statute of limitations	(1,255)	(1,277)
Balance as of April 30	\$ 5,052	\$ 5,663

The Company records interest and penalties on uncertain tax positions to income tax expense. As of April 30, 2010 and April 30, 2009, the Company had accrued approximately \$710,000 and \$711,000, respectively, of interest and penalties related to uncertain tax positions. The Company is currently under audit by various state jurisdictions but does not anticipate any material adjustments from these examinations. The tax years 2007 and 2009 remain open to examination by the IRS for federal income taxes. The tax years 2005 to 2009 remain open for major state taxing jurisdictions.

**10. Related Party Transactions**

Pursuant to a consulting agreement, the Company paid a board member approximately \$222,000, \$216,000 and \$236,000 during the years ended April 30, 2010, 2009 and 2008, respectively, for



Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

consulting services independent of his board service. The agreement stipulates the payment of approximately \$16,000 plus expenses per month, in exchange for consulting services.

During the year ended April 30, 2010, the Company made an equipment sale in the amount of \$1,705,000 to a customer with a common board member. There were no sales to this customer during the years ended April 30, 2009 and 2008. As of April 30, 2010 there was no trade receivable due from this customer.

**11. Commitments and Contingencies****Commitments**

The Company's operations are conducted in leased facilities. Following is a summary of non-cancelable operating lease commitments:

	Year ending April 30 (In thousands)
2011	\$ 3,018
2012	2,539
2013	1,824
2014	1,713
2015	427
Thereafter	
	\$ 9,521

Rental expense under operating leases was approximately \$3,660,000, \$3,348,000 and \$2,978,000 for the years ended April 30, 2010, 2009 and 2008, respectively.

**Contingencies**

The Company is subject to legal proceedings and claims which arise out of the ordinary course of its business. Although adverse decisions or settlements may occur, the Company, in consultation with legal counsel, believes that the final disposition of such matters will not have a material adverse effect on the consolidated financial position, results of operations or cash flows of the Company.

**Contract Cost Audits**

Payments to the Company on government cost reimbursable contracts are based on provisional, or estimated indirect rates, which are subject to an annual audit by the Defense Contract Audit Agency, or DCAA. The cost audits result in the negotiation and determination of the final indirect cost rates that the Company may use for the period(s) audited. The final rates, if different from the provisional rates, may create an additional receivable or liability for the Company.

For example, during the course of its audits, the DCAA may question the Company's incurred costs, and if the DCAA believes the Company has accounted for such costs in a manner inconsistent with the requirements under Federal Acquisition Regulations, or FAR, the DCAA auditor may recommend to the Company's administrative contracting officer to disallow such costs. Historically, the Company has not experienced material disallowed costs as a result of government audits. However, the Company can provide no assurance that the DCAA or other government audits will not result in material disallowances for incurred costs in the future.

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's revenue recognition policy calls for revenue recognized on all cost reimbursable government contracts to be recorded at actual rates unless collectability is not reasonably assured.

**12. Segment Data**

The Company's product segments are as follows:

Unmanned Aircraft Systems ("UAS") The UAS segment consists primarily of the design, development and manufacture of unmanned aircraft systems solutions.

Efficient Energy Systems ("EES") The EES segment consists primarily of the design, development and manufacture of system solutions for the clean transportation and clean energy markets.

The accounting policies of the segments are the same as those described in Note 1, "Organization and Significant Accounting Policies." The operating segments do not make sales to each other. Depreciation and amortization related to the manufacturing of goods is included in gross margin for the segments. The Company does not discretely allocate assets to its operating segments, nor does the CODM evaluate operating segments using discrete asset information. Consequently, the Company operates its financial systems as a single segment for accounting and control purposes, maintains a single indirect rate structure across all segments, has no inter-segment sales or corporate elimination transactions, and maintains only limited financial statement information by segment.

The segment results are as follows (in thousands):

	<b>Year Ended April 30,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Revenue:</b>			
UAS	\$ 224,179	\$ 211,364	\$ 186,615
EES	25,339	36,298	29,131
Total	249,518	247,662	215,746
<b>Gross margin:</b>			
UAS	85,157	70,968	68,598
EES	11,669	17,629	9,949
Total	96,826	88,597	78,547
<b>Selling, general and administrative</b>			
	42,429	34,246	33,662
<b>Research and development</b>			
	24,510	21,798	16,441
<b>Income from operations</b>			
	29,887	32,553	28,444
<b>Interest income</b>			
	195	1,244	3,795
<b>Income before income taxes</b>			
	\$ 30,082	\$ 33,797	\$ 32,239

**Geographic Information**

## Edgar Filing: AeroVironment Inc - Form 10-K

Sales to non-U.S. customers accounted for 7.0%, 7.0% and 6.1% of revenue for the fiscal years ended April 30, 2010, 2009 and 2008, respectively.



Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****13. Quarterly Results of Operations (Unaudited)**

The following tables present selected unaudited consolidated financial data for each of the eight quarters in the two-year period ended April 30, 2010. In the Company's opinion, this unaudited information has been prepared on the same basis as the audited information and includes all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of the financial information for the period presented. The Company's fiscal year ends on April 30. Due to the fixed year end date of April 30, the first and fourth quarters each consist of approximately 13 weeks. The second and third quarters each consist of 13 weeks. The first three quarters end on a Saturday.

	August 1, 2009	Three Months Ended October 31, 2009	January 30, 2010	April 30, 2010
(In thousands except per share data)				
<b>Year ended April 30, 2010</b>				
Revenue	\$ 37,940	\$ 51,367	\$ 60,861	\$ 99,350
Gross margin	\$ 10,715	\$ 19,649	\$ 23,481	\$ 42,981
Net (loss) income	\$ (3,587)	\$ 2,216	\$ 6,515	\$ 15,572
Net (loss) income per share basic(1)	\$ (0.17)	\$ 0.10	\$ 0.30	\$ 0.72
Net (loss) income per share diluted	\$ (0.17)	\$ 0.10	\$ 0.30	\$ 0.71

	August 2, 2008	Three Months Ended November 1, 2008	January 31, 2009	April 30, 2009
(In thousands except per share data)				
<b>Year ended April 30, 2009</b>				
Revenue	\$ 53,613	\$ 65,779	\$ 52,225	\$ 76,045
Gross margin	\$ 20,583	\$ 24,987	\$ 16,677	\$ 26,350
Net income	\$ 4,809	\$ 9,059	\$ 4,541	\$ 5,836
Net income per share basic(1)	\$ 0.23	\$ 0.43	\$ 0.21	\$ 0.27
Net income per share diluted	\$ 0.22	\$ 0.41	\$ 0.21	\$ 0.27

- (1) Earnings per share is computed independently for each of the quarters presented. The sums of the quarterly earnings per share in fiscal 2010 do not equal the total earnings per share computed for the year due to rounding.

Table of Contents

**SUPPLEMENTARY DATA**  
**SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS**

Description	Balance at Beginning of Period	Additions		Deductions	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
(In thousands)					
Allowance for doubtful accounts for the year ended April 30:					
2008	\$ 149	\$ 71	\$	\$	\$ 220
2009	\$ 220	\$ 183	\$	\$ (112)	\$ 291
2010	\$ 291	\$ 601	\$	\$ (147)	\$ 745
Warranty reserve for the year ended April 30:					
2008	\$ 263	\$ 844	\$	\$ (763)	\$ 344
2009	\$ 344	\$ 1,182	\$	\$ (1,003)	\$ 523
2010	\$ 523	\$ 1,512	\$	\$ (1,231)	\$ 804
Reserve for inventory excess and obsolescence for the year ended April 30:					
2008	\$ 1,138	\$ 455	\$	\$ (52)	\$ 1,541
2009	\$ 1,541	\$ 491	\$	\$ (643)	\$ 1,389
2010	\$ 1,389	\$ 434	\$	\$ (632)	\$ 1,191
Reserve for self-insured medical claims for the year ended April 30:					
2008	\$ 200	\$ 3,246	\$	\$ (3,047)	\$ 399
2009	\$ 399	\$ 3,758	\$	\$ (3,477)	\$ 680
2010	\$ 680	\$ 5,170	\$	\$ (4,836)	\$ 1,014

Table of Contents

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

Not applicable.

**Item 9A. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. As required by Rule 13a-15(b) under the Exchange Act, we have carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective and were operating at a reasonable level.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of management, including our principal executive and financial officers, we assessed our internal control over financial reporting as of April 30, 2010, based on criteria for effective internal control over financial reporting established in *Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway

Table of Contents

Commission (COSO). Based on this assessment, management concluded that the Company maintained effective internal control over financial reporting as of April 30, 2010 based on the specified criteria.

The effectiveness of our internal control over financial reporting as of April 30, 2010 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

**Item 9B. Other Information.**

None.

Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of AeroVironment, Inc. and Subsidiaries

We have audited AeroVironment Inc.'s internal control over financial reporting as of April 30, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). AeroVironment Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, AeroVironment, Inc. maintained, in all material respects, effective internal control over financial reporting as of April 30, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of AeroVironment, Inc. and subsidiaries as of April 30, 2010 and 2009, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended April 30, 2010 of AeroVironment, Inc. and subsidiaries and our report dated June 24, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California  
June 24, 2010

Table of Contents

**PART III**

**Item 10. Directors, Executive Officers, and Corporate Governance.**

Certain information required by Item 401 and Item 405 of Regulation S-K will be included in the Proxy Statement for our 2010 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

**Codes of Ethics**

We have adopted a Code of Business Conduct and Ethics, or Code of Conduct. The Code of Conduct is posted on our website, <http://investor.avinc.com>. We intend to disclose on our website any amendments to, or waivers of, the Code of Conduct covering our Chief Executive Officer, Chief Financial Officer and/or Controller promptly following the date of such amendments or waivers. A copy of the Code of Conduct may be obtained upon request, without charge, by contacting our Secretary at (626) 357-9983 or by writing to us at AeroVironment, Inc., Attn: Secretary, 181 W. Huntington Dr., Suite 202, Monrovia, CA 91016. The information contained or connected to our website is not incorporated by reference into this annual report on Form 10-K and should not be considered part of this or any reported filed with the SEC.

No family relationships exist among any of our executive officers or directors.

There have been no material changes to the procedures by which security holders may recommend nominees to our board of directors.

The information required by Item 407(d)(4) and (d)(5) of Regulation S-K will be included in the Proxy Statement for our 2010 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

**Item 11. Executive Compensation.**

The information required by Item 402 and Item 407(e)(4) and (5) of Regulation S-K will be included in the Proxy Statement for our 2010 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by Item 201(d) and Item 403 of Regulation S-K will be included in the Proxy Statement for our 2010 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information required by Item 404 and Item 407(a) of Regulation S-K will be included in the Proxy Statement for our 2010 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

**Item 14. Principal Accounting Fees and Services.**

The information required by Item 14 will be included in the Proxy Statement for our 2010 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

Table of Contents

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

(a)

The following are filed as part of this Annual Report on Form 10-K:

**1. Financial Statements**

The following consolidated financial statements are included in Item 8:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets at April 30, 2010 and 2009

Consolidated Statements of Income for the Years ended April 30, 2010, 2009 and 2008

Consolidated Statements of Stockholders' Equity for the Years ended April 30, 2010, 2009 and 2008

Consolidated Statements of Cash Flows for the Years ended April 30, 2010, 2009 and 2008

Notes to Consolidated Financial Statements

**2. Financial Statement Schedules**

The following Schedule is included in Item 8:

Schedule II Valuation and Qualifying Accounts

All other schedules have been omitted since the required information is not present, or not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or the Notes thereto.

Exhibits See Item 15(b) of this report below.

(b)

Exhibits

<b>Exhibit Number</b>	<b>Exhibit</b>
3.1(1)	Amended and Restated Certificate of Incorporation of AeroVironment, Inc.
3.3(2)	Second Amended and Restated Bylaws of AeroVironment, Inc.
4.1(3)	Form of AeroVironment, Inc.'s Common Stock Certificate
10.1#(3)	Form of Director and Executive Officer Indemnification Agreement
10.2#(3)	AeroVironment, Inc. Nonqualified Stock Option Plan
10.3#(3)	Form of Nonqualified Stock Option Agreement pursuant to the AeroVironment, Inc. Nonqualified Stock Option Plan
10.4#(3)	AeroVironment, Inc. Directors' Nonqualified Stock Option Plan
10.5#(3)	Form of Directors' Nonqualified Stock Option Agreement pursuant to the AeroVironment, Inc. Directors' Nonqualified Stock Option Plan
10.6#(3)	AeroVironment, Inc. 2002 Equity Incentive Plan

## Edgar Filing: AeroVironment Inc - Form 10-K

- 10.7#(3) Form of AeroVironment, Inc. 2002 Equity Incentive Plan Stock Option Agreement
- 10.8#(3) AeroVironment, Inc. 2006 Equity Incentive Plan
- 10.9#(3) Form of Stock Option Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
- 10.10#(3) Form of Performance Based Bonus Award pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
- 10.11(3) Sublease Agreement, dated February 17, 2005, among AeroVironment, Inc., L-3 Communications Corporation and Thermotrex Corporation, for the property located at 900 Enchanted Way, Simi Valley, California 93065



## Edgar Filing: AeroVironment Inc - Form 10-K

### Table of Contents

<b>Exhibit Number</b>	<b>Exhibit</b>
10.12(3)	Standard Industrial/Commercial Single-Tenant Lease, dated August 8, 2005, between AeroVironment, Inc. and FKT Associates, for the property located at 1960 Walker Ave., Monrovia, California 91016
10.13(5)	Standard Industrial/Commercial Single-Tenant Lease, dated February 12, 2007, between AeroVironment, Inc. and OMP Industrial Moreland, LLC, for the property located at 85 Moreland Road, Simi Valley, California, including the addendum thereto.
10.14(6)	Standard Industrial/Commercial Single-Tenant Lease, dated March 3, 2008, between AeroVironment, Inc. and Hillside Associates III, LLC, for the property located at 900 Enchanted Way, Simi Valley, California, including the addendum thereto.
10.15(6)	Standard Industrial/Commercial Single-Tenant Lease, dated April 21, 2008, between AeroVironment, Inc. and Hillside Associates II, LLC, for the property located at 994 Flower Glen Street, Simi Valley, California, including the addendum thereto.
10.16 (3)	AV Direct Project Request, dated July 7, 2005, between AeroVironment, Inc. and Marine Corps System Command
10.17 (3)	Award Contract, dated December 22, 2005, between AeroVironment, Inc. and Marine Corps System Command
10.18 (7)	Award Contract, dated August 15, 2005, between AeroVironment, Inc. and U.S. Army Aviation & Missile Command
10.19 (3)	Award Contract, dated September 21, 2004, between AeroVironment, Inc. and Natick Contracting Division
10.20 (3)	Award Contract, dated January 2, 2004, between AeroVironment, Inc. and U.S. Army Aviation & Missile Command
10.21 (8)	Award Contract, dated September 24, 2007, between AeroVironment, Inc. and United States Special Operations Command, as amended.
10.22 (9)	Award Contract, dated December 22, 2006, between AeroVironment, Inc. and the United States Air Force/Air Force Research Laboratory, Aeronautical Systems Center, as amended.
10.23#(2)	Standard Consulting Agreement, dated November 1, 2008, between AeroVironment, Inc. and Charles R. Holland
10.24(10)	Amendment No. 2 to Standard Consulting Agreement, dated December 17, 2009, between AeroVironment, Inc. and Charles R. Holland
10.25(10)	Task Order #FY-10-001, dated December 17, 2009, between AeroVironment, Inc. and Charles R. Holland.
10.26#(3)	Retiree Medical Plan
10.27 (7)	Award Contract, dated June 30, 2008, between AeroVironment, Inc. and United States Special Operations Command, as amended.
21.1	Subsidiaries of AeroVironment, Inc.
23.1	Consent of Ernst & Young LLP, independent registered public accounting firm
24.1	Power of Attorney (incorporated by reference to the signature page of this report on Form 10-K)
31.1	Certification Pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification Pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- 
- (1) Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10-Q filed March 9, 2007 (File No. 001-33261)
- (2) Incorporated by reference herein to the exhibits on the Company's Annual Report on Form 10-K filed June 24, 2009 (File No. 001-33261).
- (3) Incorporated by reference herein to the exhibits to the Company's Registration Statement on Form S-1 (File No. 333-137658)
- (4) Incorporated by reference herein to the exhibits to the Company's Registration Statement on Form S-8 filed January 26, 2007 (File No. 001-33261).

## Edgar Filing: AeroVironment Inc - Form 10-K

### Table of Contents

- (5) Incorporated by reference herein to the exhibits on the Company's Annual Report on Form 10-K filed June 29, 2007 (File No. 001-33261).
- (6) Incorporated by reference herein to the exhibits to the Company's Annual Report on Form 10-K filed June 26, 2008 (File No. 001-33261).
- (7) Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10-Q filed March 10, 2010 (File No. 001-33261).
- (8) Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10-Q filed December 6, 2007 (File No. 001-33261).
- (9) Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10-Q filed March 4, 2008 (File No. 001-33261).
- (10) Incorporated by reference herein to the exhibits to the Company's Current Report on Form 8-K filed December 22, 2009 (File No. 001-33261).
- (11) Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10-Q filed September 10, 2008 (File No. 001-33261).

Confidential treatment has been requested for portions of this exhibit.

# Indicates management contract or compensatory plan.

## Edgar Filing: AeroVironment Inc - Form 10-K

### Table of Contents

### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

#### AEROVIRONMENT, INC.

Date: June 24, 2010

/s/ TIMOTHY E. CONVER

---

By: Timothy E. Conver  
 Its: Chairman, Chief Executive Officer and President  
 (Principal Executive Officer)

KNOW ALL PERSONS BY THESE PRESENTS, that each of the persons whose signature appears below hereby constitutes and appoints Timothy E. Conver and Jikun Kim, each of them acting individually, as his attorney-in-fact, each with full power of substitution, for him in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming our signatures as they may be signed by our said attorney-in-fact and any and all amendments to this Annual Report on Form 10-K.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ TIMOTHY E. CONVER	Chairman, President and Chief Executive Officer and Director (Principal Executive Officer)	June 24, 2010
Timothy E. Conver /s/ JIKUN KIM	Chief Financial Officer (Principal Financial and Accounting Officer)	June 24, 2010
Jikun Kim /s/ JOSEPH F. ALIBRANDI	Director	June 24, 2010
Joseph F. Alibrandi /s/ KENNETH R. BAKER	Director	June 24, 2010
Kenneth R. Baker /s/ ARNOLD L. FISHMAN	Director	June 24, 2010
Arnold L. Fishman /s/ CHARLES R. HOLLAND	Director	June 24, 2010
Charles R. Holland		