

AeroVironment Inc  
Form 10-Q  
March 10, 2010  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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b   **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934.**

**For the quarterly period ended January 30, 2010**

**OR**

o   **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**

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**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, California**

(Address of principal executive offices)

**91016**

(Zip Code)

**(626) 357-9983**

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(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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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

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.

Large accelerated filer                       Accelerated filer                       Non-accelerated filer  
(Do not check if smaller reporting company)                       Smaller reporting company

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

As of February 26, 2010, the number of shares outstanding of the registrant's common stock, \$0.0001 par value, was 21,649,826.

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**AeroVironment, Inc.**

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****AeroVironment, Inc.****Consolidated Balance Sheets****(In thousands except share and per share data)**

	<b>January 30, 2010 (Unaudited)</b>	<b>April 30, 2009</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 52,843	\$ 116,501
Short-term investments	67,072	21,523
Accounts receivable, net of allowance for doubtful accounts of \$389 at January 30, 2010 and \$291 at April 30, 2009	40,860	42,551
Unbilled receivables and retentions	19,319	20,070
Inventories, net	29,713	11,602
Income tax receivable	3,218	3,415
Deferred income taxes	4,304	3,994
Prepaid expenses and other current assets	3,657	1,718
<b>Total current assets</b>	<b>220,986</b>	<b>221,374</b>
Long-term investments	6,582	7,156
Property and equipment, net	19,302	18,218
Deferred income taxes	6,339	6,313
Other assets	86	120
<b>Total assets</b>	<b>\$ 253,295</b>	<b>\$ 253,181</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 16,745	\$ 23,990
Wages and related accruals	8,026	10,231
Other current liabilities	5,110	3,686
Liability for uncertain tax positions	2,590	730
<b>Total current liabilities</b>	<b>32,471</b>	<b>38,637</b>
Deferred rent	1,346	1,463
Liability for uncertain tax positions	3,195	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 21,649,826 at January 30, 2010 and 21,470,481 at April 30, 2009	2	2

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Additional paid-in capital	114,023	110,102
Accumulated other comprehensive loss	(746)	(537)
Retained earnings	103,004	97,860
Total stockholders' equity	216,283	207,427
Total liabilities and stockholders' equity	\$ 253,295	\$ 253,181

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents**AeroVironment, Inc.****Consolidated Statements of Income (Unaudited)****(In thousands except share and per share data)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>January 30, 2010</b>	<b>January 31, 2009</b>	<b>January 30, 2010</b>	<b>January 31, 2009</b>
<b>Revenue:</b>				
Product sales	\$ 25,353	\$ 30,160	\$ 52,716	\$ 92,746
Contract services	35,508	22,065	97,452	78,871
	60,861	52,225	150,168	171,617
<b>Cost of sales:</b>				
Product sales	15,156	18,682	31,796	55,485
Contract services	22,224	16,866	64,527	53,885
	37,380	35,548	96,323	109,370
Gross margin	23,481	16,677	53,845	62,247
Selling, general and administrative	9,833	7,950	30,828	23,900
Research and development	5,167	4,625	16,616	14,781
Income from operations	8,481	4,102	6,401	23,566
<b>Other income:</b>				
Interest income	38	197	147	1,107
Income before income taxes	8,519	4,299	6,548	24,673
Provision (benefit) for income taxes	2,004	(242)	1,404	6,264
Net income	\$ 6,515	\$ 4,541	\$ 5,144	\$ 18,409
<b>Earnings per share data:</b>				
Basic	\$ 0.30	\$ 0.21	\$ 0.24	\$ 0.88
Diluted	\$ 0.30	\$ 0.21	\$ 0.23	\$ 0.84
<b>Weighted average shares outstanding:</b>				
Basic	21,394,204	21,147,902	21,352,838	20,937,284
Diluted	21,991,067	22,030,603	21,952,140	21,940,482

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents**AeroVironment, Inc.****Consolidated Statements of Cash Flows (Unaudited)****(In thousands)**

	<b>Nine Months Ended</b>	
	<b>January 30, 2010</b>	<b>January 31, 2009</b>
<b>Operating activities</b>		
Net income	\$ 5,144	\$ 18,409
Adjustments to reconcile net income to net cash and cash equivalents (used in) provided by operating activities:		
Depreciation and amortization	6,465	3,622
Provision for doubtful accounts	98	175
Deferred income taxes	(196)	(254)
Stock-based compensation	1,258	637
Tax benefit from exercise of stock options	1,855	11,237
Excess tax benefit from stock-based compensation	(46)	(98)
Loss (gain) on sale of property and equipment	3	(5)
Changes in operating assets and liabilities:		
Accounts receivable	1,593	(465)
Unbilled receivables and retentions	751	(2,514)
Inventories	(18,111)	(4,456)
Income tax receivable	243	(5,926)
Other assets	(1,905)	1,020
Accounts payable	(7,245)	1,648
Other liabilities	(1,497)	(2,148)
Net cash and cash equivalents (used in) provided by operating activities	(11,590)	20,882
<b>Investing activities</b>		
Acquisitions of property and equipment	(7,552)	(8,905)
Proceeds from sale of property and equipment	9	9
Net purchases of held-to-maturity investments	(45,549)	(21,514)
Net sales of available-for-sale investments	225	5,325
Net cash and cash equivalents used in investing activities	(52,876)	(25,085)
<b>Financing activities</b>		
Excess tax benefit from stock-based compensation	46	98
Exercise of stock options	762	979
Net cash and cash equivalents provided by financing activities	808	1,077
Net decrease in cash and cash equivalents	(63,658)	(3,126)
Cash and cash equivalents at beginning of period	116,501	105,064
Cash and cash equivalents at end of period	\$ 52,843	\$ 101,938
Supplemental disclosure:		
Unrealized losses on long-term investments recorded in other comprehensive income, net of deferred tax benefit of \$140 and \$365, respectively	\$ (209)	\$ (549)

See accompanying notes to consolidated financial statements (unaudited).





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**AeroVironment, Inc.**

**Notes to Consolidated Financial Statements (Unaudited)**

**1. Organization and Significant Accounting Policies**

*Organization*

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

*Basis of Presentation*

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three and nine months ended January 30, 2010 are not necessarily indicative of the results for the full year ending April 30, 2010. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended April 30, 2009, included in AeroVironment, Inc.'s Annual Report on Form 10-K.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions, including estimates of anticipated contract costs and revenue utilized in the revenue recognition process, that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to the current year presentation.

The Company's consolidated financial statements include the assets, liabilities and operating results of wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

*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 from which separate financial information is available that is evaluated regularly by the Chief Operating

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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.

### *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.

### *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.

### *Government Contracts*

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 ( 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.

Table of Contents**AeroVironment, Inc.****Notes to Consolidated Financial Statements (Unaudited)**

For example, during the course of its audits, the DCAA may question the Company's incurred project costs, and if the DCAA believes the Company has accounted for such costs in a manner inconsistent with the requirements under Federal Acquisition Regulations, the DCAA auditor may recommend to the Company's administrative contracting officer to disallow such costs. 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.

***Earnings Per Share***

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

The reconciliation of diluted to basic shares is as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>January 30, 2010</b>	<b>January 31, 2009</b>	<b>January 30, 2010</b>	<b>January 31, 2009</b>
Denominator for basic earnings per share:				
Weighted average common shares outstanding, excluding unvested restricted stock	21,394,204	21,147,902	21,352,838	20,937,284
Dilutive effect of employee stock options and unvested restricted stock	596,863	882,701	599,302	1,003,198
Denominator for diluted earnings per share	21,991,067	22,030,603	21,952,140	21,940,482

During the three and nine months ended January 30, 2010 and January 31, 2009, certain options and shares of unvested 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 shares of unvested restricted stock which met this anti-dilutive criterion was approximately 11,000 and 14,000 for the three and nine months ended January 30, 2010, respectively. The number of options and shares of unvested restricted stock which met this anti-dilutive criterion was approximately 11,000 and 19,000 for the three and nine months ended January 31, 2009, respectively.

***Recently Issued Accounting Standards***

In August 2009, the Financial Accounting Standards Board ( FASB ) issued amended standards for the fair value measurement of liabilities. These amended standards clarify that in circumstances in which a quoted price in an active market for the identical liability is not available, the Company is required to use the quoted price of the identical liability when traded as an asset, quoted prices for similar liabilities, or quoted

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prices for similar liabilities when traded as assets. If these quoted prices are not available, the Company is required to use another valuation technique, such as an income approach or a market approach. These amended standards were adopted by the Company on November 1, 2009, and did not have a significant impact on the Company's consolidated financial statements.

In October 2009, the FASB issued new standards for revenue recognition for arrangements with multiple deliverables. These new standards impact the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. Additionally, these new standards modify the manner in which the transaction consideration is allocated across the separately identified deliverables by no longer permitting the residual method of allocating arrangement consideration. These new standards are effective for the Company beginning on May 1, 2011, however, early adoption is permitted. The Company does not expect these new standards to significantly impact its consolidated financial statements.

In October 2009, the FASB issued new standards for the accounting for certain revenue arrangements that include software elements. These new standards amend the scope of pre-existing software revenue guidance by removing from the guidance non-software components of tangible products and certain software components of tangible products. These new standards are effective for the Company beginning on May 1, 2011, however, early adoption is permitted. The Company does not expect these new standards to significantly impact its consolidated financial statements.

Table of Contents**AeroVironment, Inc.****Notes to Consolidated Financial Statements (Unaudited)****2. Investments**

Investments consist of the following (in thousands):

	January 30, 2010	April 30, 2009
Short-term investments:		
Held-to-maturity securities:		
Pre-refunded municipal bond	\$	\$ 2,029
U.S. Treasury bills	67,072	19,494
Total short-term investments	\$ 67,072	\$ 21,523
Long-term investments:		
Available-for-sale securities:		
Auction rate securities	\$ 6,582	\$ 7,156
Total long-term investments	\$ 6,582	\$ 7,156

**Held-To-Maturity Securities**

At January 30, 2010, the balance of held-to-maturity securities consisted of U.S. Treasury bills. Interest earned from these investments is recorded in interest income.

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of January 30, 2010, were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury bills	\$ 67,072	\$ 8	\$	\$ 67,080
Total held-to-maturity investments	\$ 67,072	\$ 8	\$	\$ 67,080

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of April 30, 2009, were as follows (in thousands):

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	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
Pre-refunded municipal bond	\$ 2,029	\$	5	\$	\$	\$	2,034
U.S. Treasury bills	19,494		5				19,499
Total held-to-maturity investments	\$ 21,523	\$	10	\$	\$	\$	21,533

The amortized cost and fair value of the Company's held-to-maturity securities by contractual maturity at January 30, 2010, were as follows (in thousands):

	Cost		Fair Value
Due within one year	\$ 67,072	\$	67,080
Total	\$ 67,072	\$	67,080

**Available-For-Sale Securities**

As of January 30, 2010, the entire balance of available-for-sale securities consisted of four investment grade auction rate municipal bonds with maturities ranging from 9 to 25 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.

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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 January 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 January 30, 2010. 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 estimated date upon which 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 other-than-temporary impairment. 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 at maturity, and as of January 30, 2010, it did not consider these investments to be other-than-temporarily impaired.

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale investments as of January 30, 2010, were as follows (in thousands):

	<b>Amortized Cost</b>		<b>Gross Unrealized Gains</b>		<b>Gross Unrealized Losses</b>		<b>Fair Value</b>
Auction rate securities	\$ 7,825	\$		\$ (1,243)	\$		\$ 6,582
Total available-for-sale investments	\$ 7,825	\$		\$ (1,243)	\$		\$ 6,582

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale investments as of April 30, 2009, were as follows (in thousands):

	<b>Amortized Cost</b>		<b>Gross Unrealized Gains</b>		<b>Gross Unrealized Losses</b>		<b>Fair Value</b>
Auction rate securities	\$ 8,050	\$		\$ (894)	\$		\$ 7,156
Total available-for-sale investments	\$ 8,050	\$		\$ (894)	\$		\$ 7,156

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

	<b>Cost</b>	<b>Fair Value</b>
Due after five through 10 years	\$ 1,500	\$ 1,322
Due after 10 years	6,325	5,260
Total	\$ 7,825	\$ 6,582



Table of Contents**AeroVironment, Inc.****Notes to Consolidated Financial Statements (Unaudited)****3. Inventories, net**

Inventories consist of the following (in thousands):

	<b>January 30, 2010</b>	<b>April 30, 2009</b>
Raw materials	\$ 9,484	\$ 6,055
Work in process	10,265	2,351
Finished goods	11,304	4,585
Inventories, gross	31,053	12,991
Reserve for inventory obsolescence	(1,340)	(1,389)
Inventories, net	\$ 29,713	\$ 11,602

**4. 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 January 30, 2010, were as follows (in thousands):

Description	Quoted prices in active markets	Fair Value Measurement Using		Total
		Significant other	Significant unobservable	

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	for identical assets (Level 1)	observable inputs (Level 2)	inputs (Level 3)	
Cash and cash equivalents	\$ 52,843	\$	\$	\$ 52,843
Auction rate securities			6,582	6,582
<b>Total</b>	<b>\$ 52,843</b>	<b>\$</b>	<b>\$ 6,582</b>	<b>\$ 59,425</b>

Due to the auction failures of the Company's auction rate securities that began in the fourth quarter of fiscal 2008, there are still no quoted prices in active markets for identical assets as of January 30, 2010. Therefore, the Company has classified its auction rate securities as Level 3 financial assets. 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 April 30, 2009	\$ 7,156
Transfers to Level 3	
Total losses (realized or unrealized) Included in earnings	
Included in other comprehensive income	(349)
Purchases, issuances and settlements, net	(225)
Balance at January 30, 2010	\$ 6,582
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 January 30, 2010	\$

Table of Contents**AeroVironment, Inc.****Notes to Consolidated Financial Statements (Unaudited)**

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 estimated date upon which 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, allowing the Company to recover the original cost of \$7.8 million. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible other-than-temporary impairment.

**5. Other Comprehensive Income**

The components of comprehensive income are as follows (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>January 30, 2010</b>	<b>January 31, 2009</b>	<b>January 30, 2010</b>	<b>January 31, 2009</b>
Net income	\$ 6,515	\$ 4,541	\$ 5,144	\$ 18,409
Other comprehensive loss, net of tax:				
Unrealized losses on long-term investments	(140)	(549)	(209)	(549)
Comprehensive income	\$ 6,375	\$ 3,992	\$ 4,935	\$ 17,860

**6. Warranty Reserves**

The Company accrues an estimate of its exposure to warranty claims based upon both current and historical product sales data and warranty costs incurred. The warranty reserve is included in other current liabilities. The related expense is included in cost of sales. Warranty reserve activity is summarized as follows for the three and nine months ended January 30, 2010 and January 31, 2009 (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>January 30, 2010</b>	<b>January 31, 2009</b>	<b>January 30, 2010</b>	<b>January 31, 2009</b>
Beginning balance	\$ 586	\$ 399	\$ 523	\$ 344

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Warranty expense		356		295		1,057		772
Warranty costs incurred		(278)		(194)		(916)		(616)
Ending balance	\$	664	\$	500	\$	664	\$	500

**7. Customer-Funded Research & Development**

Customer-funded R&D costs are incurred pursuant to contracts (revenue arrangements) to perform R&D 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 R&D services are performed. Revenue from customer-funded R&D was approximately \$16,299,000 and \$64,080,000 for the three and nine months ended January 30, 2010, respectively. Revenue from customer-funded R&D was approximately \$16,844,000 and \$45,917,000 for the three and nine months ended January 31, 2009, respectively.

**8. Income Taxes**

For the three and nine months ended January 30, 2010, the Company recorded a provision for income taxes of \$2,004,000 and \$1,404,000, respectively, yielding an effective tax rate of 23.5% and 21.4%, respectively. The variance from statutory rates is primarily due to R&D tax credits. For the three and nine months ended January 31, 2009, the Company recorded (benefits) provisions for income taxes of (\$242,000) and \$6,264,000, respectively, yielding an effective tax rate of negative 5.6% and 25.4%, respectively. The variance from statutory rates is primarily due to R&D tax credits.

Table of Contents**AeroVironment, Inc.****Notes to Consolidated Financial Statements (Unaudited)****9. Segment Data**

The Company's product segments are as follows:

- Unmanned Aircraft Systems ( UAS ) The UAS segment consists primarily of the design, development, production and support of unmanned aircraft systems solutions.
- Efficient Energy Systems ( EES ) The EES segment consists primarily of the design, development, production and support 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 limited financial statement information by segment.

The segment results are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	January 30, 2010	January 31, 2009	January 30, 2010	January 31, 2009
<b>Revenue:</b>				
UAS	\$ 55,089	\$ 43,394	\$ 132,089	\$ 145,926
EES	5,772	8,831	18,079	25,691
Total	60,861	52,225	150,168	171,617
<b>Gross margin:</b>				
UAS	21,125	13,461	45,926	50,050
EES	2,356	3,216	7,919	12,197
Total	23,481	16,677	53,845	62,247
Selling, general and administrative	9,833	7,950	30,828	23,900
Research and development	5,167	4,625	16,616	14,781
Income from operations	8,481	4,102	6,401	23,566
Interest income	38	197	147	1,107
Income before income taxes	\$ 8,519	\$ 4,299	\$ 6,548	\$ 24,673



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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as anticipates, believes, could, estimates, expects, intends, may, potential, predicts, projects, should, will, would or similar expressions. Such forward-looking statements are based on current expectations, estimates and projections about our industry, our management's beliefs and assumptions made by our management. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A, Risk Factors.

Unless required by law, we expressly disclaim any obligation to update publicly any forward-looking statements, whether as result of new information, future events or otherwise.

**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 United States. 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

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revenue recognition, inventories and reserves for excess and obsolescence, long-term investments, 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.

There have been no material changes made to the critical accounting estimates during the periods presented in the consolidated financial statements from those disclosed in the Form 10-K for the fiscal year ended April 30, 2009.

**Fiscal Periods**

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 exactly 13 weeks. Our first three quarters end on a Saturday. Our 2010 fiscal year ends on April 30, 2010 and our fiscal quarters end on August 1, 2009, October 31, 2009 and January 30, 2010.

**Results of Operations**

Our operating segments are Unmanned Aircraft Systems, or UAS, and Efficient Energy Systems, or EES. The accounting policies for each of these segments are the same. In addition, a significant portion of our research and development, or R&D, selling, general and administrative, or SG&A, and general overhead resources are shared across our segments.

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

*Three Months Ended January 30, 2010 Compared to Three Months Ended January 31, 2009*

	<b>Three Months Ended</b>	
	<b>January 30, 2010</b>	<b>January 31, 2009</b>
<b>Revenue:</b>		
UAS	\$ 55,089	\$ 43,394
EES	5,772	8,831
Total	60,861	52,225
<b>Gross margin:</b>		
UAS	21,125	13,461
EES	2,356	3,216
Total	23,481	16,677



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Selling, general and administrative	9,833	7,950
Research and development	5,167	4,625
Income from operations	8,481	4,102
Interest income	38	197
Income before income taxes	\$ 8,519	\$ 4,299

**Revenue.** Revenue for the three months ended January 30, 2010 was \$60.9 million, as compared to \$52.2 million for the three months ended January 31, 2009, representing an increase of \$8.7 million, or 17%. UAS revenue increased \$11.7 million, or 27%, to \$55.1 million for the three months ended January 30, 2010, primarily due to increased UAS service revenue of \$13.5 million, partially offset by lower product deliveries of \$0.6 million and customer-funded R&D work of \$1.2 million. The increase in UAS service revenue was primarily due to the retrofitting of our analog Raven B systems with our Digital Data Link technology. EES revenue decreased by \$3.1 million, or 35%, to \$5.8 million for the three months ended January 30, 2010. The decrease in EES revenue was primarily due to decreased product deliveries of electric vehicle test systems and industrial fast charge systems.

**Cost of Sales.** Cost of sales for the three months ended January 30, 2010 was \$37.4 million, as compared to \$35.5 million for the three months ended January 31, 2009, representing an increase of \$1.9 million, or 5%. The increase in cost of sales was caused primarily by higher UAS cost of sales of \$4.0 million, partially offset by lower EES cost of sales of \$2.1 million.

**Gross Margin.** Gross margin for the three months ended January 30, 2010 was \$23.5 million, as compared to \$16.7 million for the three months ended January 31, 2009, representing an increase of \$6.8 million, or 41%. UAS gross margin increased \$7.7 million, or 57%, to \$21.1 million for the three months ended January 30, 2010. As a percentage of revenue, gross margin for UAS increased from

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31% to 38% primarily due to lower program costs and a higher mix of fixed price contracts versus cost-reimbursable contracts. During the same period of the prior year, gross margins were impacted by a reduced indirect rate application. EES gross margin decreased \$0.9 million, or 27%, to \$2.4 million for the three months ended January 30, 2010. As a percentage of revenue, EES gross margin increased from 36% to 41% primarily due to product mix.

**Selling, General and Administrative.** SG&A expense for the three months ended January 30, 2010 was \$9.8 million, or 16% of revenue, compared to SG&A expense of \$7.9 million, or 15% of revenue, for the three months ended January 31, 2009. SG&A expense increased \$1.9 million primarily due to higher selling and business development costs and increased bid and proposal activity.

**Research and Development.** R&D expense for the three months ended January 30, 2010 was \$5.2 million, or 8% of revenue, which was higher than R&D expense of \$4.6 million, or 9% of revenue for the three months ended January 31, 2009. The increase in R&D expense of \$0.5 million was primarily due to increased investments in support of electric vehicle charging infrastructure.

**Interest Income.** Interest income for the three months ended January 30, 2010 was \$38,000, which was lower than interest income of \$197,000 for the three months ended January 31, 2009. Interest income decreased primarily due to lower yields and lower average investment portfolio balances.

**Income Tax Expense.** Our effective income tax rate was 23.5% for the three months ended January 30, 2010, as compared to negative 5.6% for the three months ended January 31, 2009. This increase was primarily due to lower amounts of tax benefits related to federal R&D tax credits than in the prior year.

### *Nine Months Ended January 30, 2010 Compared to Nine Months Ended January 31, 2009*

	Nine Months Ended	
	January 30, 2010	January 31, 2009
<b>Revenue:</b>		
UAS	\$ 132,089	\$ 145,926
EES	18,079	25,691
Total	150,168	171,617
<b>Gross margin:</b>		
UAS	45,926	50,050
EES	7,919	12,197
Total	53,845	62,247
Selling, general and administrative	30,828	23,900
Research and development	16,616	14,781
Income from operations	6,401	23,566
Interest income	147	1,107
Income before income taxes	\$ 6,548	\$ 24,673

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**Revenue.** Revenue for the nine months ended January 30, 2010 was \$150.2 million, as compared to \$171.6 million for the nine months ended January 31, 2009, representing a decrease of \$21.4 million, or 12%. UAS revenue decreased \$13.8 million, or 9%, to \$132.1 million for the nine months ended January 30, 2010, primarily due to decreased UAS product deliveries of \$30.9 million, partially offset by higher customer-funded R&D work of \$16.8 million. The decrease in UAS product deliveries was primarily due to a reduction in our analog Raven B production as we transitioned into the production of Raven B systems with our new Digital Data Link technology. The increase in UAS customer-funded R&D revenue was primarily due to increased activity on the Global Observer program. EES revenue decreased by \$7.6 million, or 30%, to \$18.1 million for the nine months ended January 30, 2010. The decrease in EES revenue was primarily due to decreased product deliveries of electric vehicle test systems and industrial fast charge systems.

**Cost of Sales.** Cost of sales for the nine months ended January 30, 2010 was \$96.3 million, as compared to \$109.4 million for the nine months ended January 31, 2009, representing a decrease of \$13.1 million, or 12%. The decrease in cost of sales was caused by lower UAS cost of sales of \$9.7 million and EES cost of sales of \$3.4 million.

**Gross Margin.** Gross margin for the nine months ended January 30, 2010 was \$53.8 million, as compared to \$62.2 million for the nine months ended January 31, 2009, representing a decrease of \$8.4 million, or 13%. UAS gross margin decreased \$4.1 million, or 8%, to \$45.9 million for the nine months ended January 30, 2010. As a percentage of revenue, gross margin for UAS increased from 34% to 35%. EES gross margin decreased \$4.3 million, or 35%, to \$7.9 million for the nine months ended January 30, 2010. As a percentage

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of revenue, EES gross margin decreased from 47% to 44%.

**Selling, General and Administrative.** SG&A expense for the nine months ended January 30, 2010 was \$30.8 million, or 21% of revenue, compared to SG&A expense of \$23.9 million, or 14% of revenue, for the nine months ended January 31, 2009. SG&A expense increased \$6.9 million primarily due to higher selling and business development costs, increased bid and proposal activity and higher administrative infrastructure costs.

**Research and Development.** R&D expense for the nine months ended January 30, 2010 was \$16.6 million, or 11% of revenue, which was higher than R&D expense of \$14.8 million, or 9% of revenue, for the nine months ended January 31, 2009. The increase in R&D expense of \$1.8 million was primarily due to increased investments in support of electric vehicle charging infrastructure.

**Interest Income.** Interest income for the nine months ended January 30, 2010 was \$0.1 million, which was lower than interest income of \$1.1 million for the nine months ended January 31, 2009. Interest income decreased primarily due to lower yields and lower average investment portfolio balances.

**Income Tax Expense.** Our effective income tax rate was 21.4% for the nine months ended January 30, 2010, as compared to 25.4% for the nine months ended January 31, 2009. The decrease was primarily due to tax benefits related to federal R&D tax credits that were higher as a percentage of taxable income when compared to the prior year, which resulted in a lower effective tax rate.

**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 January 30, 2010 and April 30, 2009, our funded backlog was approximately \$98.7 million and \$114.8 million, respectively.

In addition to our funded backlog, we also had unfunded backlog of \$346.3 million and \$510.6 million as of January 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. The decline in unfunded backlog from April 30, 2009 to January 30, 2010 resulted primarily from the expiration of an IDIQ-type contract that had been established in 2004. 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.

## 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 global credit crisis has imposed exceptional levels of 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 services, 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 industry 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. To the extent we require additional funding, we cannot be certain that such funding will be available to us on acceptable terms, or at all. Although we are currently not a party to any agreement or letter of intent with respect to potential investment in, or

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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.

Recent global market and economic conditions have been unprecedented and challenging with tighter credit conditions and recession in most major economies. As a result of these market conditions, the cost and availability of credit has been and may continue to be adversely affected by illiquid credit markets and wider credit spreads. Concern about the stability of the markets generally and the strength of counterparties specifically has led many lenders and institutional investors to reduce, and in some cases, cease to provide credit to businesses and consumers. These factors have led to a decrease in spending by businesses and consumers alike, and a corresponding decrease in global infrastructure spending. Continued turbulence in the U.S. and international markets and economies and prolonged declines in business and consumer spending may adversely affect our liquidity and financial condition, and the liquidity and financial condition of our customers, including our ability to access the capital markets to meet liquidity needs. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits. Given the current instability of financial institutions, we cannot be assured that we will not experience losses on these deposits.

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.

**Cash Flows**

The following table provides our cash flow data for the nine months ended January 30, 2010 and January 31, 2009 (in thousands):

	Nine Months Ended	
	January 30, 2010	January 31, 2009
	(Unaudited)	
Net cash (used in) provided by operating activities	\$ (11,590)	\$ 20,882
Net cash used in investing activities	\$ (52,876)	\$ (25,085)
Net cash provided by financing activities	\$ 808	\$ 1,077

**Cash Used in Operating Activities.** Net cash used in operating activities for the nine months ended January 30, 2010 increased by \$32.5 million to \$11.6 million, compared to net cash provided by operating activities of \$20.9 million for the nine months ended January 31, 2009. This increase in net cash used in operating activities was primarily due to lower income of \$13.3 million, a reduction in tax benefits from stock-based compensation of \$9.3 million and higher working capital needs of \$13.3 million, partially offset by higher depreciation of \$2.8 million.

**Cash Used in Investing Activities.** Net cash used in investing activities increased by \$27.8 million to \$52.9 million for the nine months ended January 30, 2010, compared to net cash used in investing activities of \$25.1 million for the nine months ended January 31, 2009. The increase in net cash used in investing activities was primarily due to an increase in net purchases of investments of \$29.1 million, partially offset by lower acquisition of property and equipment of \$1.4 million.

**Cash Provided by Financing Activities.** Net cash provided by financing activities decreased by \$0.3 million to \$0.8 million for the nine months ended January 30, 2010, compared to \$1.1 million for the nine months ended January 31, 2009. During the nine months ended January 30, 2010, we received proceeds from stock option exercises of \$0.8 million.

#### **Off-Balance Sheet Arrangements**

During the third quarter, there were no material changes in our off balance sheet arrangements or contractual obligations and commercial commitments from those disclosed in the Form 10-K for the fiscal year ended April 30, 2009.

#### **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.

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**New Accounting Standards**

Please refer to Note 1 Organization and Significant Accounting Policies to our unaudited consolidated financial statements in Part I, Item 1 of this quarterly report for a discussion of new accounting pronouncements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

In the ordinary course of business, we are exposed to various market risk factors, including fluctuations in interest rates, changes in general economic conditions, domestic and foreign competition, and foreign currency exchange rates. Please refer to Item 7A, Quantitative and Qualitative Disclosures About Market Risk, contained in our Annual Report on Form 10-K for the fiscal year ended April 30, 2009, for further discussion on 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.

**ITEM 4. CONTROLS AND PROCEDURES**

***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.



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In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only 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 carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and 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 assurance level.

### *Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting or in other factors identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the quarter ended January 30, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. 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 1A. RISK FACTORS**

There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended April 30, 2009.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
10.1	Award Contract, dated August 15, 2005, between AeroVironment, Inc. and U.S. Army Aviation & Missile Command, as amended as of December 2, 2009.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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Confidential treatment has been requested for portions of this exhibit.

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**SIGNATURES**

Pursuant to the requirements 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.

Date: March 10, 2010

AEROVIRONMENT, INC.

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

/s/ Stephen C. Wright  
Stephen C. Wright  
Chief Financial Officer  
(Principal Financial and Accounting Officer)