

AeroVironment Inc  
Form 10-K  
June 24, 2009

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**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, 2009**

**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:**

|   |  |
|---|--|
| <b>Title of Class</b>                             | <b>Name of each exchange on which registered</b> |
| <b>Common Stock, par value \$0.0001 per share</b> | <b>The NASDAQ Stock Market LLC</b>               |

**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

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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 (§229.405 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 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<br>filer <input type="checkbox"/> | Accelerated<br>filer <input type="checkbox"/> | Non-accelerated<br>filer <input type="checkbox"/>   | Smaller reporting<br>company <input type="checkbox"/> |
|   |   | (Do not check if a<br>smaller reporting<br>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 November 1, 2008 was approximately \$592.4 million.

As of June 12, 2009, the issuer had 21,470,481 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, 2009, are incorporated by reference into Part III of this Form 10-K.

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**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 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;

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 industrial vehicle batteries and electric vehicle test systems devices 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 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



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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.

Prior to May 1, 2008, our operating segments were UAS, PosiCharge Systems and Energy Technology Center. Effective May 1, 2008, we consolidated the operations of two of our business segments to reflect the change in the management and organizational structure that occurred on May 1, 2008. The change in the management and organizational structure was made to take advantage of operational synergies and optimize management time by focusing on two as opposed to three business segments. PosiCharge Systems and Energy Technology Center were consolidated into one segment named Efficient Energy Systems. As required by Statement of Financial Accounting Standards ("SFAS") No. 131, we have restated the historical segment information for the fiscal years ended April 30, 2008 and 2007, to be consistent with the current reportable segment structure.

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.

**Our Strategy**

We intend to grow our business by maintaining leadership in the markets for UAS, electric vehicle charging systems and electric vehicle test systems and by creating new products 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 electric vehicle 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 electric vehicle 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 and services, both in response to and in anticipation of customer needs. We believe that by continuing to invest in research and development, we will continue to deliver innovative, new products 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.

***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

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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 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, 2009, approximately 43% 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 U.S. Military. Other U.S. government agencies and government subcontractors accounted for 38% of our sales revenue, while purchases by foreign and commercial customers accounted for the remaining 19% of sales revenue during our fiscal year ended April 30, 2009.

**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 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, Warrior and Reaper, to small systems, such as our Raven and Wasp, are an integral part 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. Additionally, given the embedded nature of 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, 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 operate at lower altitudes, but are unable to maintain geosynchronous positions, meaning they are moving with



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respect to the surface of the earth, resulting in limited coverage over areas of interest, and significant periods of time during which they do not cover those areas. An unmanned aircraft that is capable of operating for extended periods over an area of interest while carrying a communications relay or observation payload in an affordable manner could help to address this need.

**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 *in situ*. 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 chargers that require up to eight hours to completely recharge a battery pack, to extremely fast chargers that can do so in a very short amount of time.

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 the 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 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 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.

**Electric Vehicle Test Systems**

Developers of battery electric and hybrid electric 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,

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including battery electric and hybrid electric 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 more funding and attention is focused on clean transportation.

**Our Solutions**

**UAS Products**

Our small UAS, including *Raven*, *Wasp*, and *Puma AE*, 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, enabling the operator to view and capture images, during the day or at night, on a hand-held ground control unit. All of our ground control units 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 units 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 enemy 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 due to 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 warfighters to deploy these assets directly.

Our small UAS also include spare equipment, alternative payload modules, batteries, chargers, repairs 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. We currently maintain a forward operating depot in Iraq to support the large fleet of our small UAS deployed there. 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 research and development efforts. This approach enables us to improve our solutions in response to, and in anticipation of, evolving customer needs.

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 57% as of April 30, 2009. For the fiscal years ended April 30, 2009, 2008 and 2007, sales of our UAS products and services accounted for 85%, 86% and 84%, respectively, of our revenue.

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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 III</b>   | 2.4            | 1.0           | Horizontal autonomous landing capable                 | Electro-optical and infrared                            | 5.0            | 45                    |
| <b>Puma AE</b>    | 9.2            | 13            | Vertical autonomous landing capable (ground or water) | Mechanical pan, tilt, zoom electro-optical and infrared | 6.0            | 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.

In January 2009, we received the initial production order for the introduction of our digital data link, DDL, to replace the analog data link used by all of our small UAS. The result of a successful development program, digital data link will enhance the capabilities, and ultimately, the utility of our small UAS by enabling more efficient radio spectrum utilization and communications security. Small UAS incorporating our digital data link will 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 digital data link will enable 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 that provides 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, which also serves as the primary depot for repairs and spare parts, is currently supplemented by a forward supply depot in Iraq.

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 offer turnkey flight operation services to customers requiring the information generated by our small UAS.

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**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 and clean energy solutions, and performs contract engineering services. These solutions consist of PosiCharge electric vehicle charging systems for industrial electric material handling fleets, and electric vehicle test systems for developers of hybrid and electric vehicles as well as battery packs, electric motors and fuel cells. For the fiscal years ended April 30, 2009, 2008 and 2007, Efficient Energy Systems sales accounted for 15%, 14% and 16%, respectively, of our revenue. We believe that the markets for our electric vehicle charging systems and electric vehicle test systems continue to develop and that continued diversification of our customer base will support increased penetration into target markets.

**PosiCharge 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.

Developed over years of advanced battery testing and usage, 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 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.

Our complete line of electric vehicle charging products enables us to design customized system solutions for each facility based on its shift schedule, workload, truck type and battery type. By customizing the system to unique customer requirements, we can help to reduce the cost of implementing and operating fast charge systems while maximizing the benefit of PosiCharge systems to our customers. Our complete solution consists of system configuration, installation, training, asset management and performance monitoring. Moreover, while fast charge technology itself provides significant operational and financial benefits to our customers, we believe that our ability to integrate the system effectively into customer operations through installation services, asset management capabilities and post-sale support increases the value proposition. We believe that this "turnkey" approach to the fast charge market represents a potential source of competitive advantage.

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

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industrial vehicles who use PosiCharge fast charge 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 consist of the following:

**PosiCharge ELT.** ELT, our original fast charge product, is designed to safely deliver the highest current (up to 600 amps) to electric forklifts, such as counterbalance or "sit-down" trucks, used in heavy-duty applications.

**PosiCharge DVS.** Capable of charging either one vehicle at a time at up to 500 amps or two vehicles simultaneously at up to 320 amps each, DVS is designed to deliver lower up-front installation and ongoing utility costs when compared to other single vehicle fast chargers. Because DVS is a high-current, stand-alone system, it is capable of supporting a variety of specific charging needs, including isolated vehicles in remote areas, smaller fleets requiring smaller systems and heavy-duty applications with variable usage patterns.

**PosiCharge MVS.** MVS, a multiple-port, multi-vehicle fast charge system, is designed for charging low-to-medium-duty electric industrial vehicles, such as pallet jacks, reach trucks and tow motors, in distribution, warehousing, and general manufacturing settings. Each system is capable of charging up to 16 vehicles at the same time and is designed to deliver greater cost-savings as the number of vehicles simultaneously charged increases.

**PosiCharge SVS.** A cost-effective, flexible fast charge solution for single vehicle applications, the SVS line of fast charge systems has a compact footprint and provides up to 500 amps of current through its single port.

**PosiCharge GSE.** Ruggedized for outdoor use in extreme weather conditions, GSE is designed to deliver all the benefits of our MVS product to the airport ground support equipment market.

**PosiCharge eSVS.** The eSVS opportunity charger line provides a total fleet solution with the intelligence necessary for true opportunity charging for low duty vehicles. Optimized for safety, run time and battery life, the fully automatic eSVS features equalization and anti-arcing safeguards and is best suited for low usage electric vehicles in single and light duty double shifts.

**Accessories.** In addition to charging systems, we offer a variety of accessories to help our customers integrate PosiCharge into their operations. Single point, automatic watering systems ensure that battery electrolyte is maintained at an optimal level and that watering occurs at the optimal time, thereby contributing to battery health and reducing labor costs associated with manual watering. Charge indicator lights provide fleet supervisors with color codes visible from a distance that indicate the status of the battery's charge. Battery-mounted fans for use with the heaviest-duty types of vehicles keep these batteries cool to improve battery performance. Cable management options and charger stands provide customers the flexibility to install PosiCharge in the best location.

### **Electric Vehicle Test Systems**

We supply a line of electric vehicle 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 +/-250kW) of bi-directional DC equipment, our EV 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

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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 internal 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. 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, 2009 and April 30, 2008, our funded backlog was approximately \$114.8 million and \$82.0 million, respectively. We expect that 90% of our funded backlog will be filled during our fiscal year ending April 30, 2010.

In addition to our funded backlog, we had unfunded backlog of \$510.6 million and \$384.3 million as of April 30, 2009 and April 30, 2008, 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 creating our 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, the world's first liquid

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hydrogen-powered UAS. The Smithsonian Institution has selected four 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               |

We follow a formal process to evaluate new ideas and inventions that ultimately includes review by our commercialization committee to determine if a technology, product or solution is commercially feasible. The committee members are selected by our Chief Executive Officer. Currently our commercialization committee consists of our Chief Executive Officer and Chief Financial Officer. In addition, each of our operating segments has its own internal evaluators who determine whether potential commercialization opportunities and intellectual property developments merit review by our commercialization committee. 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, 2009, we had 96 currently effective issued patents and approximately 75 patents pending. In many cases, we opt to protect our intellectual property through trade secrets as opposed to filing for patent protection in order to preserve the confidentiality of such intellectual property.

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.

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**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 2009, we began the transition of our Digital Data Link, a communications capability for our small UAS, from development to production with the receipt of an initial production order. Four development programs are described below.

**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 sponsored 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, self-launching 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 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 is 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 targets, 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.



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**Passenger and Fleet Electric Vehicle Fast Charge Systems.** Based on over a decade of successful electric vehicle fast charging, and drawing experience gained in the development of the GM Impact, we are introducing a line of fast and conventional charging systems designed to enable the safe and reliable recharge of advanced electric vehicle battery packs. This line of systems supports the increased interest in and funding for practical, clean transportation solutions. We have delivered prototype units to customers and are focusing on system reliability and safety.

For the fiscal years ended April 30, 2009, 2008 and 2007, our internal research and development spending amounted to 9%, 8% and 8%, respectively, of our revenue, and customer-funded research and development spending amounted to an additional 27%, 13% and 11%, 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 AeroVironment® and PosiCharge® and have submitted several other applications for trademark registration, including for *AV*, *Global Observer* and *Architectural Wind*.

**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.

**PosiCharge Systems**

We primarily sell our PosiCharge 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 fast charge 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 fast charge 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.

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**Electric Vehicle Test Systems**

We sell our electric vehicle 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 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.

**International Sales**

We are increasing our sales efforts abroad and have employees in country or 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, 2009.

**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 execute production of new small UAS products at low initial rates, high-volume, full-rate production, and 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. 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 ISO certification, integrated supply chain strategy, document control systems, and process control methodologies into this new manufacturing effort 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

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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 International Organization for Standardization, or 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.

**Efficient Energy Systems Manufacturing and Operations**

We perform final assembly and testing of our PosiCharge fast charge systems and electric vehicle 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.

**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. 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.

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 fast charge 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 fast charge systems reduces or eliminate the need for extra batteries.

Direct competitors for our electric vehicle test systems include Bitrode Corporation and Digatron Firing Circuits.

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**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, due to the nature of the products and services we provide, 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 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

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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 approved annually. We are currently the sole provider and prime contractor under all of the programs of record established by the DoD for small UAS.

**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.

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**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 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

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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.

**Contract Mix**

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

|                              | <b>Fiscal Year Ended</b> |             |             |
|------------------------------|--------------------------|-------------|-------------|
|                              | <b>April 30,</b>         |             |             |
|                              | <b>2009</b>              | <b>2008</b> | <b>2007</b> |
| Fixed-price contracts        | 59%                      | 59%         | 65%         |
| Cost reimbursable contracts  | 40%                      | 40%         | 34%         |
| Time-and-materials contracts | 1%                       | 1%          | 1%          |

**Employees**

As of April 30, 2009, we had 658 full-time employees, of whom 259 were in research and development and engineering, 72 were in sales and marketing, 200 were in operations and 127 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 the Company of approximately \$80.5 million, after deducting payment of underwriters' discounts and commissions and offering expenses.

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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 82% of our revenue for the fiscal year ended April 30, 2009. The DoD, our principal U.S. government customer, accounted for approximately 78% of our revenue for the fiscal year ended April 30, 2009. 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 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.



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***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, fast charge 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;
- manage growth in our operations;
- develop and renew contracts;
- attract and retain additional engineers and other highly-qualified personnel;
- 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.

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The primary direct competitors to our PosiCharge business are other fast charge suppliers, including Aker Wade Power Technologies LLC and PowerDesigners, LLC, 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

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other test system suppliers, including Bitrode Corporation and Digatron Firing Circuits. 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 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, 2009, UAS, and Electric Vehicle Charging and Test Systems, accounted for 85% and 15% 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 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;

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.

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***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 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 electric vehicle fast charge and test systems to large industrial electric vehicle fleet operators primarily in North America and our electric vehicle 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 electric vehicle fast charge 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

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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.

***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 \$21.8 million, or 9% of our revenue, in our fiscal year ended April 30, 2009 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

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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 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.

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***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, 2009. 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.

***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 electric vehicle fast charge 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 fast charge 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. Although we maintain insurance policies, we cannot assure you that this insurance will be adequate to protect us from all material

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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 number of UAS that can operate simultaneously in a given geographic area is limited by the allocated frequency spectrum available. 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.

***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



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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

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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 PosiCharge 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.***

Our PosiCharge fast charge 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 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 fast charge business is dependent upon our relationships with battery dealers and other third parties with whom we do not have exclusive arrangements.***

To remain competitive in the market for fast charge 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 PosiCharge fast charge system customers. Currently, several of our fast charge 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 PosiCharge fast charge 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.

***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 2009, 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

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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, 2009, our \$7.2 million of long-term investments, recorded at fair value, consisted entirely of auction rate municipal bonds with maturities that range from approximately 10 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, 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.

In 2008 and 2009, we experienced several 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 12, 2009, including the securities involved in failed auctions, we held approximately \$7.2 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



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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 25 years) to realize our investments' purchase price of \$8.0 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 ongoing 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. This financial crisis could impact 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.

*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.

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***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, 2009. 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;

changes in 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 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.***

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:

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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;

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;

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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 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.



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**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

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 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



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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 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 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 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. Therefore, an unfavorable outcome to an audit by the DCAA or another 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.

***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.

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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;

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

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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 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**

***Our common stock has only been publicly traded since January 23, 2007 and the price of our common stock may fluctuate significantly.***

There has only been a public market for our common stock since January 23, 2007. 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

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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;

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,

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securities class action 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 12, 2009, our directors, executive officers and their affiliates collectively beneficially owned 5,165,661 shares, or approximately 24%, 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.

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

Not Applicable.

**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 square feet and leases that expire between the end of 2009 and 2010.

Our principal UAS facilities are located in Simi Valley, California. As of April 30, 2009, 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 small leased offices in Florida and Virginia for training, business development and sales, and 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. Submission of Matters to a Vote of Securities Holders.**

No matters were submitted during the fourth quarter of our fiscal year ended April 30, 2009 to a vote of security holders through solicitation of proxies or otherwise.



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

On January 23, 2007, our common stock was listed on the NASDAQ Global Market under the symbol "AVAV." Prior to January 23, 2007, there was no established trading market for our common stock. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock from May 1, 2007 through April 30, 2009. 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, |         |         |         |
|----------------|-----------------------------|---------|---------|---------|
|                | 2009                        |         | 2008    |         |
|                | High                        | Low     | High    | Low     |
| First Quarter  | \$32.98                     | \$22.82 | \$23.43 | \$19.76 |
| Second Quarter | \$36.64                     | \$25.08 | \$26.93 | \$17.97 |
| Third Quarter  | \$40.50                     | \$28.50 | \$26.52 | \$20.26 |
| Fourth Quarter | \$41.22                     | \$18.50 | \$24.35 | \$18.44 |

On June 12, 2009, the closing sales price of our common stock as reported on the NASDAQ Global Select Market was \$27.28 per share. As of June 12, 2009, there were approximately 43 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.

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**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.

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

**Performance Graph Table (\$)**

|                     | 22-Jan-07 | 26-Jan-07 | 30-Apr-07 | 27-Jul-07 | 26-Oct-07 | 25-Jan-08 | 30-Apr-08 | 01-Aug-08 | 31-Oct-08 | 30-Jan-09 | 30-Apr-09 |
|---------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| AeroVironment Stock | 100       | 136       | 126       | 118       | 150       | 137       | 141       | 192       | 211       | 218       | 139       |
| Russell 2000 Index  | 100       | 101       | 105       | 100       | 106       | 89        | 92        | 92        | 69        | 57        | 63        |
| SPADES Index        | 100       | 101       | 108       | 116       | 128       | 108       | 112       | 100       | 76        | 73        | 72        |

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, |            |            |            |            |
|---|----------------------|------------|------------|------------|------------|
|   | 2009                 | 2008       | 2007       | 2006       | 2005       |
| <b>(In thousands, except per share data)</b>          |                      |            |            |            |            |
| <b>Consolidated Income Statement Data:</b>            |                      |            |            |            |            |
| Revenue   | \$ 247,662           | \$ 215,746 | \$ 173,721 | \$ 139,357 | \$ 105,155 |
| Net income  | \$ 24,245            | \$ 21,386  | \$ 20,718  | \$ 11,208  | \$ 14,570  |
| <b>Earnings per common share:</b>                     |                      |            |            |            |            |
| Basic   | \$ 1.15              | \$ 1.08    | \$ 1.39    | \$ 0.86    | \$ 1.15    |
| Diluted   | \$ 1.11              | \$ 1.00    | \$ 1.22    | \$ 0.75    | \$ 1.05    |
| Weighted average common shares outstanding (basic):   | 21,024               | 19,767     | 14,947     | 13,012     | 12,675     |
| Weighted average common shares outstanding (diluted): | 21,776               | 21,372     | 16,992     | 14,874     | 13,847     |
| <b>Balance Sheet Data</b>                             |                      |            |            |            |            |
| Total assets  | \$ 253,181           | \$ 205,211 | \$ 168,177 | \$ 64,950  | \$ 50,440  |
| Long-term obligations                                 | \$ 7,117             | \$ 5,460   | \$ 541     | \$ 2,617   | \$ 1,500   |

**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 20, 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 industrial vehicle batteries and test systems for electric vehicles and generation devices 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 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

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

Prior to May 1, 2008, our operating segments were UAS, PosiCharge Systems and Energy Technology Center. Effective May 1, 2008, we consolidated the operations of two of our business segments to reflect the change in the management and organizational structure that occurred on May 1, 2008. The change in the management and organizational structure was made to take advantage of operational synergies and optimize management time by focusing on two as opposed to three business segments. PosiCharge Systems and Energy Technology Center were consolidated into one segment named Efficient Energy Systems. As required by SFAS No. 131, we have restated the historical segment information for the fiscal years ended April 30, 2008 and 2007, to be consistent with the current reportable segment structure.

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.

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**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.

**Income Tax Expense**

Our effective tax rates are substantially lower than the statutory rates primarily due to research and development tax credits and federal tax exempt municipal bond interest income.

**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 Financial Accounting Standards Board Emerging Issues Task Force No. 00-21, Revenue Arrangements with Multiple Deliverables, or EITF 00-21. EITF 00-21 provides for deferral to higher authoritative guidance, including American Institute of Certified Public Accountants Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, or SOP 81-1, under

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which the majority of our contracts are properly accounted for. Contracts which provide for multiple deliverables to which SOP 81-1 does not apply are accounted for in accordance with the provisions of EITF 00-21.

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 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. Revenue on arrangements that are not within the scope of SOP 81-1 is recognized in accordance with the SEC Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements."

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**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. 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.

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### 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, |      |            |      |            |      |
|-------------------------------------|-----------------------------|------|------------|------|------------|------|
|                                     | 2009                        |      | 2008       |      | 2007       |      |
| Revenue                             | \$ 247,662                  | 100% | \$ 215,746 | 100% | \$ 173,721 | 100% |
| Cost of sales                       | 159,065                     | 64%  | 137,199    | 64%  | 105,239    | 61%  |
| Gross margin                        | 88,597                      | 36%  | 78,547     | 36%  | 68,482     | 39%  |
| Selling, general and administrative | 34,246                      | 14%  | 33,662     | 16%  | 24,041     | 14%  |
| Research and development            | 21,798                      | 9%   | 16,441     | 8%   | 13,940     | 8%   |
| Income from operations              | 32,553                      | 13%  | 28,444     | 13%  | 30,501     | 18%  |
| Interest income                     | 1,244                       | 1%   | 3,796      | 2%   | 1,707      | 1%   |
| Interest expense                    |                             | 0%   | (1)        | 0%   | (6)        | 0%   |
| Income before income taxes          | 33,797                      | 14%  | 32,239     | 15%  | 32,202     | 19%  |
| Income tax expense                  | 9,552                       | 4%   | 10,853     | 5%   | 11,484     | 7%   |
| Net income                          | \$ 24,245                   | 10%  | \$ 21,386  | 10%  | \$ 20,718  | 12%  |

Prior to May 1, 2008, our operating segments were UAS, PosiCharge Systems and Energy Technology Center. As of May 1, 2008, the operations of our PosiCharge Systems and Energy Technology Center segments were consolidated to form the newly named Efficient Energy Systems segment. The accounting policies for each of our three prior segments and for each of our two current segments are the same. In addition, a significant portion of our research and development, selling, general and administrative, and general overhead resources were shared across our segments. As required by SFAS No. 131, we have restated the historical segment information for the fiscal years ended April 30, 2008 and 2007, to be consistent with the current reportable segment structure.

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

|               | Fiscal Year Ended April 30, |            |            |
|---------------|-----------------------------|------------|------------|
|               | 2009                        | 2008       | 2007       |
|               | (In thousands)              |            |            |
| Revenue:      |                             |            |            |
| UAS           | \$ 211,364                  | \$ 186,615 | \$ 146,538 |
| EES           | 36,298                      | 29,131     | 27,183     |
| Total         | \$ 247,662                  | \$ 215,746 | \$ 173,721 |
| Gross margin: |                             |            |            |
| UAS           | \$ 70,968                   | \$ 68,598  | \$ 57,591  |
| EES           | 17,629                      | 9,949      | 10,891     |
| Total         | \$ 88,597                   | \$ 78,547  | \$ 68,482  |

### 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



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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 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.

**Fiscal Year Ended April 30, 2008 Compared to Fiscal Year Ended April 30, 2007**

**Revenue.** Revenue for the fiscal year ended April 30, 2008 was \$215.7 million, as compared to \$173.7 million for the fiscal year ended April 30, 2007, representing an increase of \$42.0 million, or 24%. UAS revenue increased \$40.1 million, or 27%, to \$186.6 million for the fiscal year ended April 30, 2008, primarily due to substantially higher UAS services, customer-funded research and development work, and product deliveries. The higher UAS service revenue was primarily due to additional services to refurbish, reconstitute, and repair delivered Raven units. The increase in customer-funded research and development work was primarily due to the increased activity associated

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with Global Observer. The increase in product sales resulted primarily from the increased sales of our *Wasp* products. EES revenue increased by \$1.9 million, or 7% to \$29.1 million for the fiscal year ended April 30, 2008, primarily due to higher installations of our PosiCharge fast charge systems products among automotive customers and Architectural Wind early adopter system sales.

**Cost of Sales.** Cost of sales for the fiscal year ended April 30, 2008 was \$137.2 million, as compared to \$105.2 million for the fiscal year ended April 30, 2007, representing an increase of \$32.0 million, or 30%. The increase in cost of sales was caused primarily by higher UAS cost of sales of \$29.1 million and higher EES cost of sales of \$2.9 million. The increase in UAS cost of sales was primarily due to growth in our UAS services operations, an increase in customer-funded research and development, and higher product deliveries. The increase in EES cost of sales was primarily due to higher sales volume, higher manufacturing support costs and sales of Architectural Wind early adopter systems.

**Gross Margin.** Gross margin for the fiscal year ended April 30, 2008 was \$78.5 million, as compared to \$68.5 million for the fiscal year ended April 30, 2007, representing an increase of \$10.1 million, or 15%. As a percentage of revenue, gross margin decreased from 39% to 36%. UAS gross margin increased \$11.0 million to \$68.6 million for the fiscal year ended April 30, 2008, primarily due to increased sales volume. As a percentage of revenue, gross margin for UAS decreased from 39% to 37%. EES gross margin decreased \$0.9 million to \$9.9 million for the fiscal year ended April 30, 2008, due to higher manufacturing and engineering sustaining support costs. As a percentage of revenue, EES gross margin decreased from 40% to 34%.

**Selling, General and Administrative.** SG&A expense for the fiscal year ended April 30, 2008 was \$33.7 million, or 16% of revenue, compared to SG&A expense of \$24.0 million, or 14% of revenue, for the fiscal year ended April 30, 2007, which included the supplemental executive retirement plan reversal of \$2.2 million. Without the reversal, SG&A expense increased \$7.5 million, primarily due to higher selling and marketing infrastructure associated with business growth and added expense for being a public company.

**Research and Development.** R&D expense for the fiscal year ended April 30, 2008 was \$16.4 million, or 8% of revenue, which was higher than R&D expense of \$13.9 million, or 8% of revenue, for the fiscal year ended April 30, 2007 primarily due to increased activity on the Global Observer program. Customer-funded R&D work for the fiscal year ended April 30, 2008 increased \$8.9 million, or 46%, to \$28.3 million, primarily due to increased activity on the Global Observer program.

**Interest Income.** Interest income for the fiscal year ended April 30, 2008 was \$3.8 million, as compared to interest income of \$1.7 million for the fiscal year ended April 30, 2007, representing an increase of \$2.1 million. Interest income increased primarily due to investing the initial public offering funds invested in auction rate securities for a longer period of fiscal 2008.

**Income Tax Expense.** Our effective income tax rate was 33.7% for the fiscal year ended April 30, 2008, as compared to 35.7% for the fiscal year ended April 30, 2007. This decrease was largely due to higher levels of tax-exempt interest income received from our short-term investments.

**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

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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 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. 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.

**Cash Flows**

The following table provides our cash flow data as of:

|   | <b>Fiscal Year Ended April 30,</b> |             |             |
|---|------------------------------------|-------------|-------------|
|   | <b>2009</b>                        | <b>2008</b> | <b>2007</b> |
|   | <b>(In thousands)</b>              |             |             |
| Net cash provided by operating activities           | \$ 39,770                          | \$ 15,502   | \$ 15,022   |
| Net cash (used in) provided by investing activities | \$(29,480)                         | \$ 67,022   | \$(91,348)  |
| Net cash provided by financing activities           | \$ 1,147                           | \$ 1,620    | \$ 81,858   |

**Cash Provided by Operating Activities.** 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 higher working capital 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.

Net cash provided by operating activities for the fiscal year ended April 30, 2008 increased by \$0.5 million to \$15.5 million, compared to net cash provided by operating activities of \$15.0 million for the fiscal year ended April 30, 2007. This increase in net cash provided by operating activities was primarily due to an increase in tax benefits from stock options exercises of \$10.2 million, the reversal of the supplemental executive retirement plan accrual in the prior year of \$2.2 million, higher depreciation

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and amortization expense of \$0.9 million, and higher net income of \$0.7 million partially offset by higher working capital needs of \$9.9 million and higher deferred income taxes of \$3.9 million.

**Cash Used in Investing Activities.** 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.

Net cash provided by investing activities increased by \$158.3 million to \$67.0 million for the fiscal year ended April 30, 2008, compared to net cash used in investing activities of \$91.3 million for the fiscal year ended April 30, 2007. The increase in net cash provided by investing activities was primarily due to net redemption of tax exempt municipal auction rate securities of \$163.2 million partially offset by higher capital expenditures of \$4.9 million. During the fiscal year ended April 30, 2008 and April 30, 2007, we used cash to purchase property and equipment totaling \$7.9 million and \$3.0 million, respectively.

**Cash Provided by Financing Activities.** 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.

Net cash provided by financing activities decreased by \$80.3 million to \$1.6 million for the fiscal year ended April 30, 2008, compared to \$81.9 million for the fiscal year ended April 30, 2007. On January 23, 2007, we completed an initial public offering that provided net proceeds of \$80.5 million. In addition, during the fiscal year ended April 30, 2008 and April 30, 2007, we received proceeds from stock option exercises of \$1.2 million and \$0.2 million, respectively.

**Line of Credit and Term Loan Facilities**

We had a revolving line of credit with a bank, under which we were able to borrow up to \$25.0 million. Effective June 23, 2008, we cancelled the line of credit with the bank to avoid unused commitment fees.

**Contractual Obligations**

The following table describes our commitments to settle contractual obligations as of April 30, 2009:

|                             | Total            | Payments Due By Period |                 |                 | More Than 5 Years |
|-----------------------------|------------------|------------------------|-----------------|-----------------|-------------------|
|                             |                  | Less Than 1 Year       | 1 to 3 Years    | 3 to 5 Years    |                   |
| (In thousands)              |                  |                        |                 |                 |                   |
| Operating lease obligations | \$ 12,478        | \$ 3,234               | \$ 5,280        | \$ 3,537        | \$ 427            |
| Purchase obligations(1)     | 22,701           | 22,701                 |                 |                 |                   |
| <b>Total</b>                | <b>\$ 35,179</b> | <b>\$ 25,935</b>       | <b>\$ 5,280</b> | <b>\$ 3,537</b> | <b>\$ 427</b>     |

(1) Consists of all cancelable and non-cancelable purchase orders as of April 30, 2009.

**Off-Balance Sheet Arrangements**

As of April 30, 2009, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of the SEC's Regulation S-K.



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**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 September 2006, the Financial Accounting Standards Board ("FASB,") issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which for us is the year beginning May 1, 2008. In February 2008, the FASB issued FASB Staff Position Financial Accounting Standard 157-2, *Effective Date of FASB Statement No. 157* ("FSP FAS 157-2"), which permits a one-year deferral of the application of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We adopted SFAS No. 157 for financial assets and liabilities effective May 1, 2008. We will apply the principles of SFAS No. 157 for non-financial assets and non-financial liabilities on May 1, 2009 and do not expect the provisions to have a material effect on our financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159"). SFAS No. 159 permits companies to choose to measure at fair value certain financial instruments and other items that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We adopted SFAS No. 159 on May 1, 2008 and elected not to measure any additional financial instruments or other items at fair value.

In December 2007, the FASB issued SFAS No. 141R (revised 2007), *Business Combinations* ("SFAS No. 141R"), which is a revision of SFAS No. 141, *Business Combinations*. In accordance with the new standard, upon initially obtaining control, the acquiring entity in a business combination must recognize 100% of the fair values of the acquired assets, including goodwill, and assumed liabilities, with only limited exceptions even if the acquirer has not acquired 100% of its target. As a consequence, the current step acquisition model will be eliminated. Also, contingent consideration arrangements will be recorded at fair value at the acquisition date and included on that basis in the purchase price consideration. In addition, all transaction costs will be expensed as incurred. SFAS No. 141R is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008, which for us is the year beginning May 1, 2009. Adoption is prospective and early adoption is not permitted. We will apply SFAS No. 141R to any acquisitions occurring after May 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51* ("SFAS No. 160"). SFAS No. 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008, which for us is the year beginning May 1, 2009. The adoption of SFAS No. 160 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In October 2008, the FASB issued FASB Staff Position Financial Accounting Standard 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* ("FSP FAS 157-3"), which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS 157-3 was effective for and adopted by the Company on October 10, 2008, the date of issuance. FSP FAS 158-3 was consistent with the

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Company's adoption of SFAS No. 157 and, therefore, did not have a material impact on the Company's financial position, results of operations or cash flows.

In April 2009, the FASB issued FASB Staff Position Financial Accounting Standard 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP FAS 157-4"). This provides additional guidance in estimating fair value when the volume and level of activity for the asset or liability have significantly decreased as well as indicating circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim periods ending after June 15, 2009, which is the year beginning May 1, 2009 for the Company, but early adoption is permitted for interim periods ending after March 15, 2009. The adoption of FSP FAS 157-4 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events." SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS No. 165 is effective for reporting periods ending after June 15, 2009, which for us is the year beginning May 1, 2009. The adoption of SFAS No. 166 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

**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.

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

**AeroVironment, Inc.**

**Audited Consolidated Financial Statements**

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**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.**



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**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, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended April 30, 2009. 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 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, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended April 30, 2009, 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, 2009, 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 23, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California  
June 23, 2009

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**AEROVIRONMENT, INC.**  
**CONSOLIDATED BALANCE SHEETS**

(In thousands except share data)

|  | April 30,         |                   |
|--|-------------------|-------------------|
|  | 2009              | 2008              |
| <b>Assets</b>  |                   |                   |
| Current assets:  |                   |                   |
| Cash and cash equivalents  | \$ 116,501        | \$ 105,064        |
| Short-term investments   | 21,523            | 13,375            |
| Accounts receivable, net of allowance for doubtful accounts of \$291 at April 30, 2009 and \$220 at April 30, 2008 | 42,551            | 29,788            |
| Unbilled receivables and retentions  | 20,070            | 20,590            |
| Inventories, net   | 11,602            | 15,923            |
| Income tax receivable  | 3,415             | 2,432             |
| Deferred income taxes  | 3,994             | 2,810             |
| Prepaid expenses and other current assets  | 1,718             | 2,014             |
| <b>Total current assets</b>  | <b>221,374</b>    | <b>191,996</b>    |
| Long-term investments  | 7,156             |                   |
| Property and equipment, net  | 18,218            | 10,308            |
| Deferred income taxes  | 6,313             | 2,785             |
| Other assets   | 120               | 122               |
| <b>Total assets</b>  | <b>\$ 253,181</b> | <b>\$ 205,211</b> |
| <b>Liabilities and stockholders' equity</b>  |                   |                   |
| Current liabilities:   |                   |                   |
| Accounts payable   | \$ 23,990         | \$ 14,080         |
| Wages and related accruals   | 10,231            | 10,428            |
| Other current liabilities  | 3,686             | 3,786             |
| Liability for uncertain tax positions  | 730               | 1,717             |
| <b>Total current liabilities</b>   | <b>38,637</b>     | <b>30,011</b>     |
| Deferred rent  | 1,463             | 941               |
| Liability for uncertain tax positions  | 5,654             | 4,519             |
| 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 21,470,481 shares at April 30, 2009 and 20,614,044 at April 30, 2008                 | 2                 | 2                 |
| Additional paid-in capital   | 110,102           | 96,123            |
| Accumulated other comprehensive loss   | (537)             |                   |
| Retained earnings  | 97,860            | 73,615            |
| <b>Total stockholders' equity</b>  | <b>207,427</b>    | <b>169,740</b>    |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 253,181</b> | <b>\$ 205,211</b> |

See accompanying notes to consolidated financial statements.



## AEROVIRONMENT, INC.

## CONSOLIDATED STATEMENTS OF INCOME

(In thousands except share and per share data)

|   | Year Ended April 30, |            |            |
|---|----------------------|------------|------------|
|   | 2009                 | 2008       | 2007       |
| <b>Revenue:</b>                             |                      |            |            |
| Product sales                               | \$ 136,173           | \$ 123,074 | \$ 116,361 |
| Contract services                           | 111,489              | 92,672     | 57,360     |
|   | 247,662              | 215,746    | 173,721    |
| <b>Cost of sales:</b>                       |                      |            |            |
| Product sales                               | 82,427               | 73,424     | 67,410     |
| Contract services                           | 76,638               | 63,775     | 37,829     |
|   | 159,065              | 137,199    | 105,239    |
| Gross margin                                | 88,597               | 78,547     | 68,482     |
| Selling, general and administrative         | 34,246               | 33,662     | 24,041     |
| Research and development                    | 21,798               | 16,441     | 13,940     |
| Income from operations                      | 32,553               | 28,444     | 30,501     |
| <b>Other income (expense):</b>              |                      |            |            |
| Interest income                             | 1,244                | 3,796      | 1,707      |
| Interest expense                            |                      | (1)        | (6)        |
| Income before income taxes                  | 33,797               | 32,239     | 32,202     |
| Provision for income taxes                  | 9,552                | 10,853     | 11,484     |
| Net income                                  | \$ 24,245            | \$ 21,386  | \$ 20,718  |
| <b>Earnings per share data:</b>             |                      |            |            |
| Net income                                  |                      |            |            |
| Basic                                       | \$ 1.15              | \$ 1.08    | \$ 1.39    |
| Diluted                                     | \$ 1.11              | \$ 1.00    | \$ 1.22    |
| <b>Weighted average shares outstanding:</b> |                      |            |            |
| Basic                                       | 21,023,590           | 19,766,881 | 14,946,502 |
| Diluted                                     | 21,775,727           | 21,372,405 | 16,992,012 |

See accompanying notes to consolidated financial statements.

## AEROVIRONMENT, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands except share data)

|   | Common Stock |        | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total      |
|---|--------------|--------|----------------------------------|----------------------|---|------------|
|   | Shares       | Amount |                                  |                      |   |            |
| Balance at April 30, 2006   | 13,283,770   |        | \$ 2,211                         | \$ 32,092            | \$  | \$ 34,303  |
| Stock options exercised   | 346,939      |        | 220                              |                      |   | 220        |
| Tax benefit from exercise of<br>stock options                             |              |        | 629                              |                      |   | 629        |
| Stock repurchased   | (7,037)      |        |                                  |                      |   |            |
| Stock based compensation  |              |        | 58                               |                      |   | 58         |
| Issuance of stock in initial<br>public offering, net of<br>offering costs | 5,252,285    | 2      | 80,493                           |                      |   | 80,495     |
| Net income  |              |        |                                  | 20,718               |   | 20,718     |
| Balance at April 30, 2007   | 18,875,957   | 2      | 83,611                           | 52,810               |   | 136,423    |
| Adjustment to initially apply<br>the provisions of FIN No. 48             |              |        |                                  | (581)                |   | (581)      |
| Stock options exercised   | 1,738,087    |        | 1,209                            |                      |   | 1,209      |
| Tax benefit from exercise of<br>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<br>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<br>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 |

See accompanying notes to consolidated financial statements.

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

|  | <b>Year ended April 30,</b> |               |                 |
|--|-----------------------------|---------------|-----------------|
|  | <b>2009</b>                 | <b>2008</b>   | <b>2007</b>     |
| <b>Operating activities</b>  |                             |               |                 |
| Net income   | \$ 24,245                   | \$ 21,386     | \$ 20,718       |
| Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities: |                             |               |                 |
| Depreciation and amortization  | 5,355                       | 3,849         | 2,897           |
| Long-term retirement costs   |                             |               | (2,209)         |
| Provision for doubtful accounts  | 71                          | (71)          | 63              |
| Deferred income taxes  | (4,355)                     | (3,104)       | 823             |
| Stock-based compensation   | 926                         | 490           | 58              |
| Tax benefit from exercise of stock options   | 11,906                      | 10,791        | 629             |
| Excess tax benefit from exercise of stock options  | (98)                        | (22)          |                 |
| Loss (gain) on disposition of property and equipment   | 17                          |               | (5)             |
| Changes in operating assets and liabilities:   |                             |               |                 |
| Accounts receivable  | (12,834)                    | (22,026)      | 13,828          |
| Unbilled receivables and retentions  | 520                         | 5,904         | (21,651)        |
| Inventories  | 4,321                       | (1,908)       | (2,562)         |
| Income tax receivable  | (983)                       | (2,432)       |                 |
| Prepaid expenses and other assets  | 298                         | (513)         | (883)           |
| Accounts payable   | 9,910                       | (1,944)       | 7,503           |
| Customer advances  | (87)                        | 123           | (8,892)         |
| Other liabilities  | 558                         | 4,979         | 4,705           |
| <b>Net cash and cash equivalents provided by operating activities</b>                                  | <b>39,770</b>               | <b>15,502</b> | <b>15,022</b>   |
| <b>Investing activities</b>  |                             |               |                 |
| Acquisition of property and equipment  | (13,302)                    | (7,928)       | (3,038)         |
| Net purchases of held-to-maturity investments  | (21,523)                    |               |                 |
| Net sales (purchases) of available-for-sale investments  | 5,325                       | 74,950        | (88,325)        |
| Proceeds from sale of property and equipment   | 20                          |               | 15              |
| <b>Net cash and cash equivalents (used in) provided by investing activities</b>                        | <b>(29,480)</b>             | <b>67,022</b> | <b>(91,348)</b> |
| <b>Financing activities</b>  |                             |               |                 |
| Transfer from restricted cash  |                             | 389           | 1,143           |
| Repayments of line of credit   |                             |               | (6,232)         |
| Proceeds from line of credit   |                             |               | 6,232           |
| Excess tax benefit from exercise of stock options  | 98                          | 22            |                 |
| Exercise of stock options  | 1,049                       | 1,209         | 220             |
| Net proceeds from initial public offering  |                             |               | 80,495          |
| <b>Net cash and cash equivalents provided by financing activities</b>                                  | <b>1,147</b>                | <b>1,620</b>  | <b>81,858</b>   |
| Net increase in cash and cash equivalents  | 11,437                      | 84,144        | 5,532           |
| Cash and cash equivalents at beginning of year   | 105,064                     | 20,920        | 15,388          |
| Cash and cash equivalents at end of year   | \$ 116,501                  | \$ 105,064    | \$ 20,920       |

**Supplemental disclosures of cash flow information**

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Cash paid during the year for:

|              |    |       |    |       |    |       |
|--------------|----|-------|----|-------|----|-------|
| Interest     | \$ | \$    | 1  | \$    | 6  |       |
| Income taxes | \$ | 2,781 | \$ | 4,484 | \$ | 6,211 |

**Non-cash investing activities**

Unrealized losses on long-term investments recorded in other

comprehensive income, net of deferred tax benefit of \$357 \$ 537

See accompanying notes to consolidated financial statements.

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**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, as defined by Statement of Financial Accounting Standards ("SFAS") No. 131, *Disclosures about Segments of an Enterprise and Related Information* ("SFAS No. 131"), 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.

Effective May 1, 2008, the Company consolidated the operations of two of its business segments to reflect the change in the management and organizational structure that occurred on May 1, 2008. The change in the management and organizational structure was made to take advantage of operational synergies and optimize management time by focusing on two as opposed to three business segments. PosiCharge Systems and Energy Technology Center were consolidated into one segment named Efficient Energy Systems. As required by SFAS No. 131, the Company has revised its historical segment information for the years ended April 30, 2008 and 2007, to be consistent with the current reportable segment structure. The consolidation of the two segments had no effect on the Company's financial position, results of operations or cash flows for the periods presented.

**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, and estimates of anticipated contract costs and revenue utilized in the revenue recognition process. Actual results could differ from those estimates.



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**AEROVIRONMENT, INC.**

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

**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.

**Investments**

The Company's investments are accounted for under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, 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.

On May 1, 2008, the Company adopted the provisions of SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and emphasizes that fair value is a market-based measurement, not an entity-specific measurement. SFAS No. 157 establishes a fair value hierarchy and expands disclosures about fair value measurements in both interim and annual periods.

**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

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

are with a limited number of corporations and governmental entities. In the aggregate, 78%, 80% and 80% of the Company's revenue came from agencies of the U.S. government for the years ended April 30, 2009, 2008 and 2007, respectively. These agencies accounted for 63% and 78% of the accounts receivable balances at April 30, 2009 and 2008, respectively. One such agency, the U.S. Army, accounted for 43%, 62% and 56% of the Company's consolidated revenue for the years ended April 30, 2009, 2008 and 2007, respectively. The U.S. Army accounted for approximately 51%, 71% and 66% of UAS reportable segment sales for the years ended April 30, 2009, 2008 and 2007, 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.

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.

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**AEROVIRONMENT, INC.**

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

The Company reviews the recoverability of its long-lived assets as required by SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, or SFAS No. 144, 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, 2009 and 2008, 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.

**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, 2009 and 2008, the Company estimated and recorded a self insurance liability in wages and related accruals of approximately \$680,000 and \$399,000, respectively.

**Income Taxes**

The Company accounts for income taxes in accordance with Financial Accounting Standards Board ("FASB") SFAS No. 109, *Accounting for Income Taxes*, or SFAS No. 109. 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 FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48. This interpretation clarifies the accounting for uncertainty in income tax recognized in an entity's financial statements in accordance with SFAS No. 109. FIN 48 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.

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**AEROVIRONMENT, INC.**

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

**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 FASB Emerging Issues Task Force No. 00-21, *Revenue Arrangements with Multiple Deliverables*, or EITF 00-21. EITF 00-21 provides for deferral to higher authoritative guidance, including American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, or SOP 81-1, under which the majority of the Company's contracts are properly accounted for. Contracts which provide for multiple deliverables to which SOP 81-1 does not apply are accounted for in accordance with the provisions of EITF 00-21.

EITF 00-21 addresses accounting for arrangements under which a vendor will perform multiple revenue-generating activities. Under EITF 00-21, 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.

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

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**AEROVIRONMENT, INC.**

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

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**

Prior to May 1, 2006, the Company accounted for incentive stock plans in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, or APB 25, and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock Based Compensation*. No stock based employee compensation was reflected in net income, as all options granted under those plans had an exercise price equal to the fair value of the underlying common stock on the date of grant. Effective May 1, 2006 the Company adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, or SFAS No. 123(R), using the prospective-transition method.

**Share Repurchases**

The Company repurchased shares in accordance with various repurchase agreements prior to the termination of such agreements upon the consummation of the Company's initial public offering on January 26, 2007. Such agreements gave the Company the right to repurchase shares from employees upon their separation from the Company and specified the terms of such repurchase. These repurchase agreements, which were entered into by employees in connection with grants of options by the Company pursuant to its stock-based compensation plans, provided that the Company had the option to repurchase shares from such employees at a price that was equal to either (i) the price paid for shares of the Company's common stock in a substantial transaction that occurred in the last year or (ii) in the event that no such substantial transaction had occurred in the last year, at a price based upon a multiple of the Company's pre-tax profits. This repurchase price was intended to approximate the fair market value of the repurchased shares. In the event that shares were repurchased within six months of exercise, compensation expense was recorded in accordance with FASB interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, or FIN 44. The Company recognized compensation expense related to shares repurchased within six months of exercise of approximately \$12,000 for the year ended April 30, 2007.

Repurchased shares are restored to the status of authorized but unissued shares.

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**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 \$66,321,000, \$28,280,000 and \$19,438,000 for the years ended April 30, 2009, 2008 and 2007, respectively. The related costs of sales for customer-funded research and development totaled approximately \$46,493,000, \$19,631,000 and \$13,460,000 for the years ended April 30, 2009, 2008 and 2007, respectively.

**Lease Accounting**

The Company accounts for its leases under the provisions of SFAS No. 13, *Accounting for Leases*, and subsequent amendments, which require that leases be evaluated and classified 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 \$1,463,000 and \$941,000 as of April 30, 2009 and 2008, 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 \$549,000, \$426,000 and \$338,000 for the years ended April 30, 2009, 2008 and 2007, 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.

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

The reconciliation of diluted to basic shares is as follows:

|  | Year Ended April 30, |                |                |
|--|----------------------|----------------|----------------|
|  | 2009                 | 2008           | 2007           |
| <b>Numerator for basic earnings per share:</b>                 |                      |                |                |
| Net income   | \$24,245,000         | \$21,386,000   | \$20,718,000   |
| <b>Denominator for basic earnings per share:</b>               |                      |                |                |
| Weighted average common shares                                 | 21,023,590           | 19,766,881     | 14,946,502     |
| Dilutive effect of employee stock options and restricted stock | 752,137              | 1,605,524      | 2,045,510      |
| <br>Denominator for diluted earnings per share                 | <br>21,775,727       | <br>21,372,405 | <br>16,992,012 |

During the years ended April 30, 2009 and 2008, certain options 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 104,000 and 379,000 for the years ended April 30, 2009 and 2008, respectively. During the year ended April 30, 2007, there were no stock options that were anti-dilutive to earnings per share.

**Recently Issued Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which is the year beginning May 1, 2008 for the Company. In February 2008, the FASB issued FASB Staff Position Financial Accounting Standard 157-2, *Effective Date of FASB Statement No. 157* ("FSP FAS 157-2"), which permits a one-year deferral of the application of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted SFAS No. 157 for financial assets and liabilities effective May 1, 2008. The Company will apply the principles of SFAS No. 157 for non-financial assets and non-financial liabilities on May 1, 2009 and does not expect the provisions to have a material effect on its financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159"). SFAS No. 159 permits companies to choose to measure at fair value certain financial instruments and other items that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 on May 1, 2008 and elected not to measure any additional financial instruments or other items at fair value.

In December 2007, the FASB issued SFAS No. 141R (revised 2007), *Business Combinations* ("SFAS No. 141R"), which is a revision of SFAS No. 141, *Business Combinations*. In accordance with the new standard, upon initially obtaining control, the acquiring entity in a business combination must recognize 100% of the fair value of the acquired assets, including goodwill, and assumed liabilities, with only limited exceptions even if the acquirer has not acquired 100% of its target. As a consequence, the current step acquisition model will be eliminated. Also, contingent consideration arrangements will be recorded at fair value at the acquisition date and included on that basis in the purchase price consideration. In addition, all transaction costs will be expensed as incurred. SFAS No. 141R is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008, which is the year

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**AEROVIRONMENT, INC.**

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

beginning May 1, 2009 for the Company. Adoption is prospective and early adoption is not permitted. The Company will apply SFAS No. 141R to any acquisitions occurring after May 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51* ("SFAS No. 160"). SFAS No. 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008, which is the year beginning May 1, 2009 for the Company. The adoption of SFAS No. 160 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In October 2008, the FASB issued FASB Staff Position Financial Accounting Standard 157-3, "*Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*" ("FSP FAS 157-3"), which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS 157-3 was effective for and adopted by the Company on October 10, 2008, the date of issuance. FSP FAS 158-3 was consistent with the Company's adoption of SFAS No. 157 and, therefore, did not have a material impact on the Company's financial position, results of operations or cash flows.

In April 2009, the FASB issued FASB Staff Position Financial Accounting Standard 157-4, "*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*" ("FSP FAS 157-4"). This provides additional guidance in estimating fair value when the volume and level of activity for the asset or liability have significantly decreased as well as indicating circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim periods ending after June 15, 2009, which is the year beginning May 1, 2009 for the Company, but early adoption is permitted for interim periods ending after March 15, 2009. The adoption of FSP FAS 157-4 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

In May 2009, the FASB issued SFAS No. 165, "*Subsequent Events*." SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS No. 165 is effective for reporting periods ending after June 15, 2009, which is the year beginning May 1, 2009 for the Company. The adoption of SFAS No. 166 is not expected to have a material impact on the Company's financial position, results of operations or cash flows.



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

Investments consist of the following:

|                                     | April 30,       |                 |
|-------------------------------------|-----------------|-----------------|
|                                     | 2009            | 2008            |
|                                     | (In thousands)  |                 |
| <b>Short-term investments:</b>      |                 |                 |
| Held-to-maturity securities:        |                 |                 |
| Pre-refunded municipal bond         | \$ 2,029        | \$              |
| U.S. Treasury bills                 | 19,494          |                 |
| Available-for-sale securities:      |                 |                 |
| Auction rate securities             |                 | 13,375          |
| <b>Total short-term investments</b> | <b>\$21,523</b> | <b>\$13,375</b> |
| <b>Long-term investments:</b>       |                 |                 |
| Available-for-sale securities:      |                 |                 |
| Auction rate securities             | \$ 7,156        | \$              |
| <b>Total long-term investments</b>  | <b>\$ 7,156</b> | <b>\$</b>       |

**Held-To-Maturity Securities**

At April 30, 2009, the balance of held-to-maturity securities consisted of one 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:

|   | 2009                |                              |                               | 2008                |                   |                              |                               |               |
|---|---------------------|------------------------------|-------------------------------|---------------------|-------------------|------------------------------|-------------------------------|---------------|
|   | Amortized<br>Cost   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value       | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Pre-refunded<br>municipal bond                    | \$ 2,029,000        | \$ 5,000                     | \$                            | \$ 2,034,000        | \$                |                              | \$                            | \$            |
| U.S. Treasury bills                               | 19,494,000          | 5,000                        |                               | 19,499,000          |                   |                              |                               |               |
| <b>Total<br/>held-to-maturity<br/>investments</b> | <b>\$21,523,000</b> | <b>\$ 10,000</b>             | <b>\$</b>                     | <b>\$21,533,000</b> | <b>\$</b>         |                              | <b>\$</b>                     | <b>\$</b>     |

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

The amortized cost and fair value of the Company's held-to-maturity securities by contractual maturity at April 30, 2009, are as follows:

|                     | <b>Cost</b>  | <b>Fair Value</b> |
|---------------------|--------------|-------------------|
| Due within one year | \$21,523,000 | \$21,533,000      |
| Total               | \$21,523,000 | \$21,533,000      |

**Available-For-Sale Securities**

As of April 30, 2009 and 2008, the entire balance of available-for-sale securities consisted entirely of investment grade auction rate municipal bonds with maturities ranging from 10 to 26 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, 2009 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, 2009 and 2008. 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. At April 30, 2008, the Company classified its auction rate securities as short-term investments. However, due to financial market conditions, the remaining four auction rate securities have been reclassified as long-term investments since the end of our second quarter of fiscal 2009. 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 less 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, 2009, it did not consider these investments to be other-than-temporarily impaired.

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

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

|                                | April 30,       |                  |
|--------------------------------|-----------------|------------------|
|                                | 2009            | 2008             |
|                                | (In thousands)  |                  |
| <b>Auction rate securities</b> |                 |                  |
| Amortized cost                 | \$ 8,050        | \$ 13,375        |
| Gross unrealized gains         |                 |                  |
| Gross unrealized losses        | (894)           |                  |
| <b>Fair value</b>              | <b>\$ 7,156</b> | <b>\$ 13,375</b> |

The amortized cost and fair value of the Company's auction rate securities by contractual maturity at April 30, 2009, are as follows:

|                     | Cost           | Fair Value |
|---------------------|----------------|------------|
|                     | (In thousands) |            |
| Due after ten years | \$ 8,050       | \$ 7,156   |
| Total               | \$ 8,050       | \$ 7,156   |

**3. Fair Value Measurements**

As discussed in Note 1, the Company adopted SFAS No. 157, subject to the deferral provisions of FSP FAS 157-2, on May 1, 2008. This standard defines fair value, establishes a framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS No. 157 defines fair value as 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 prescribed by SFAS No. 157 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.

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

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS No. 157 at April 30, 2009, were as follows (in thousands):

| Description               | Fair Value Measurement Using  |   |  | Total             |
|---------------------------|---|---|--|-------------------|
|                           | Quoted prices<br>in<br>active markets<br>for identical<br>assets<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |                   |
| Cash and cash equivalents | \$ 116,501  | \$  | \$   | \$ 116,501        |
| Auction rate securities   |   |   | 7,156  | 7,156             |
| <b>Total</b>              | <b>\$ 116,501</b>   | <b>\$</b>   | <b>\$ 7,156</b>                                    | <b>\$ 123,657</b> |

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<br>Measurements<br>Using<br>Significant<br>Unobservable<br>Inputs<br>(Level 3)<br>Auction Rate<br>Securities |
|---|---|
| Balance at May 1, 2008                    | \$ 13,375   |
| Transfers to Level 3                      |   |
| Total losses (realized or unrealized)     |   |
| Included in earnings                      |   |
| Included in other comprehensive income    | (894)   |
| Purchases, issuances and settlements, net | (5,325)   |
| Balance at April 30, 2009                 | \$ 7,156  |

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, 2009

\$

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.

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Inventories, net**

Inventories consist of the following:

|                                    | April 30,      |           |
|------------------------------------|----------------|-----------|
|                                    | 2009           | 2008      |
|                                    | (In thousands) |           |
| Raw materials                      | \$ 6,055       | \$ 6,855  |
| Work in process                    | 2,351          | 4,958     |
| Finished goods                     | 4,585          | 5,651     |
| Inventories, gross                 | 12,991         | 17,464    |
| Reserve for inventory obsolescence | (1,389)        | (1,541)   |
| Inventories, net                   | \$ 11,602      | \$ 15,923 |

**5. Property and Equipment, net**

Property and equipment consist of the following:

|  | April 30,      |           |
|--|----------------|-----------|
|  | 2009           | 2008      |
|  | (In thousands) |           |
| Leasehold improvements                         | \$ 6,709       | \$ 4,799  |
| Machinery and equipment                        | 18,183         | 10,539    |
| Furniture and fixtures                         | 2,047          | 1,905     |
| Computer equipment and software                | 6,012          | 6,166     |
| Construction in process                        | 1,961          | 693       |
| Property and equipment, gross                  | 34,912         | 24,102    |
| Less accumulated depreciation and amortization | (16,694)       | (13,794)  |
| Property and equipment, net                    | \$ 18,218      | \$ 10,308 |

**6. Warranty Reserves**

Warranty reserve activity is summarized as follows:

|                         | April 30,      |        |
|-------------------------|----------------|--------|
|                         | 2009           | 2008   |
|                         | (In thousands) |        |
| Beginning balance       | \$ 344         | \$ 263 |
| Warranty expense        | 1,182          | 844    |
| Warranty costs incurred | (1,003)        | (763)  |
| Ending balance          | \$ 523         | \$ 344 |

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**AEROVIRONMENT, INC.**

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

**7. Bank Borrowings**

As of April 30, 2008, the Company had a working capital line of credit with a bank with a borrowing limit of \$25,000,000. Borrowings bore interest at the bank's prime commercial lending rate minus 0.25%, which was 5.00% as of April 30, 2008. The line of credit was secured by substantially all of the Company's assets. Interest on amounts outstanding under the line of credit was due monthly. All principal plus accrued but unpaid interest on the line of credit would have been due August 31, 2009. The Company had no outstanding balance on the line of credit as of April 30, 2008. The credit facility contained several financial covenants, including maximum liquidity and leverage ratios, and limitations on additional indebtedness. The facility included customary default provisions, and all outstanding obligations may have become immediately due and payable in the event of the Company's default. The Company was in compliance with these covenants as of April 30, 2008.

Effective June 23, 2008, the Company cancelled the line of credit with the bank to avoid unused commitment fees.

**8. Employee Savings Plan**

The Company has an employee 401(k) savings plan covering all eligible employees. The Company expensed approximately \$1,790,000, \$1,392,000 and \$1,140,000 in contributions to the plan for the years ended April 30, 2009, 2008 and 2007, respectively.

**9. Supplemental Executive Retirement Plan**

On May 19, 2005, the Company implemented a Supplemental Executive Retirement Plan, or SERP, which is a non-qualified executive benefit plan in which the Company agreed to pay the Chairman of the Board, or Chairman, additional benefits at retirement. The SERP was an unfunded plan, which means that there were no specific assets set aside by the Company. The Chairman had no rights under the agreement beyond those of a general creditor of the Company. During the year ended April 30, 2006, the Company recognized approximately \$2,209,000 of selling, general and administrative expense charged to operations and recorded such expense as a long-term liability in connection with this plan. The SERP was fully vested on May 19, 2006, the first anniversary of the Chairman's participation. Pursuant to the terms of the agreement, upon the completion of the Company's initial public offering of equity securities, all benefits to be paid under the SERP were forfeited. Accordingly, the long-term liability of \$2,209,000 was reversed in January 2007 and recorded as a reduction to selling, general, and administrative expense.

**10. Equity**

On January 26, 2007, the Company completed its initial public offering, consisting of 5,252,285 shares of common stock. As part of the offering, an additional 2,452,715 shares were sold by selling stockholders. A total of 7,705,000 shares were sold at a public offering price of \$17.00, resulting in net proceeds to the Company of approximately \$80.5 million, after deducting payment of underwriters' discounts and commissions and offering expenses.

In connection with the initial public offering, the Company reincorporated in Delaware, effective on December 6, 2006, and effected a 7.0378-to-one stock split on January 18, 2007.

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**AEROVIRONMENT, INC.**

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

**11. Stock-Based Compensation**

The Company adopted SFAS No. 123R effective May 1, 2006. Because the Company historically used the minimum value method of measuring stock options, implementation of SFAS No. 123R applies prospectively to new awards after adoption. No expense is recognized for options granted prior to adoption. For the years ended April 30, 2009, 2008 and 2007, the Company recorded stock-based compensation expense of approximately \$926,000, \$490,000 and \$58,000, 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. 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.

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**AEROVIRONMENT, INC.**

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

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, 2009, 2008 and 2007:

|   | Year Ended April 30, |         |         |
|---|----------------------|---------|---------|
|   | 2009                 | 2008    | 2007    |
| Expected term (in years)                  | 5.84                 | 6.50    | 6.50    |
| Expected volatility                       | 20.83%               | 19.50%  | 22.41%  |
| Risk-free interest rate                   | 2.33%                | 4.60%   | 4.56%   |
| Expected dividend                         |                      |         |         |
| Weighted average fair value at grant date | \$ 6.66              | \$ 7.49 | \$ 4.12 |

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, as permitted under SFAS No. 123(R). 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.

Information related to the stock option plans at April 30, 2009, 2008 and 2007, and for the years then ended is as follows:

|                                       | 2006 Plan |  | 2002 Plan |  | 1994 Directors'<br>Plan |  | 1992 Plan   |  |
|---------------------------------------|-----------|--|-----------|--|-------------------------|--|-------------|--|
|                                       | Shares    | Weighted<br>Average<br>Exercise<br>Price | Shares    | Weighted<br>Average<br>Exercise<br>Price | Shares                  | Weighted<br>Average<br>Exercise<br>Price | Shares      | Weighted<br>Average<br>Exercise<br>Price |
| Outstanding at April 30, 2006         |           | \$                                       | 1,636,640 | \$ 1.08                                  | 70,378                  | \$ 0.59                                  | 2,048,704   | \$ 0.56                                  |
| Options granted                       |           |  | 123,162   | 11.79                                    |                         |  |             |  |
| Options exercised                     |           |  | (204,858) | 0.69                                     | (35,189)                | 0.59                                     | (106,998)   | 0.59                                     |
| Options canceled                      |           |  | (22,521)  | 4.39                                     |                         |  |             |  |
| 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 exercisable at April 30, 2009 | 53,762    | \$ 21.97                                 | 347,885   | \$ 2.08                                  |                         |  | 402,164     | \$ 0.48                                  |





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**AEROVIRONMENT, INC.**

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

The total intrinsic value of all options exercised during the years ended April 30, 2009, 2008 and 2007 was approximately \$21,177,000, \$35,874,000, and \$589,000. The intrinsic value of all options outstanding at April 30, 2009 and 2008 was \$22,218,000 and \$38,863,000, respectively. The intrinsic value of all exercisable options at April 30, 2009 and 2008, was \$16,921,000 and \$28,723,000, respectively.

A summary of the status of the Company's non-vested stock options as of April 30, 2009 and the year then ended is as follows:

| Non-vested Options           | Shares    | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|------------------------------|-----------|--|
| Non-vested at April 30, 2008 | 836,766   | \$ 6.88  |
| Granted                      | 160,000   | 6.66   |
| Cancelled                    | (70,563)  | 6.97   |
| Vested                       | (247,332) | 6.79   |
| Non-vested at April 30, 2009 | 678,871   | \$ 6.82  |

As of April 30, 2009, there was approximately \$2,626,000 of total unrecognized compensation cost related to non-vested share-based compensation awards granted under the stock option plans. That cost is expected to be recognized over an approximately five-year period or a weighted average period of approximately four years.

The weighted average fair value of options issued for the years ended April 30, 2009, 2008 and 2007 was \$6.66, \$7.49 and \$4.12, respectively. The total fair value of shares vesting during the years ended April 30, 2009, 2008 and 2007 was \$637,000, \$94,000 and \$7,000, respectively.

Proceeds from all option exercises under all stock option plans for the years ended April 30, 2009, 2008 and 2007 were approximately \$1,049,000, \$1,209,000 and \$220,000, respectively. The tax benefit realized from option exercises during the years ended April 30, 2009, 2008 and 2007 was approximately \$12,004,000 \$10,813,000, and \$629,000, respectively.

The following tabulation summarizes certain information concerning outstanding and exercisable options at April 30, 2009:

| Range of Exercise Prices | Options Outstanding        |   |  | Options Exercisable        |  |
|--------------------------|----------------------------|---|--|----------------------------|--|
|                          | As of<br>April 30,<br>2009 | Weighted<br>Average<br>Remaining<br>Contractual<br>Life In<br>Years | Weighted<br>Average<br>Exercise<br>Price | As of<br>April 30,<br>2009 | Weighted<br>Average<br>Exercise<br>Price |
| \$ 0.37                  | 197,595                    | 4.49  | \$ 0.37                                  | 197,595                    | \$ 0.37                                  |
| 0.59                     | 204,569                    | 7.42  | 0.59                                     | 204,569                    | 0.59                                     |
| 0.64-0.78                | 252,348                    | 4.27  | 0.73                                     | 196,743                    | 0.72                                     |
| 2.13                     | 243,735                    | 6.47  | 2.13                                     | 124,091                    | 2.13                                     |
| 11.79                    | 87,225                     | 7.07  | 11.79                                    | 27,051                     | 11.79                                    |
| 19.76-24.09              | 442,210                    | 8.67  | 21.84                                    | 53,762                     | 21.97                                    |
| 32.19                    | 55,000                     | 9.25  | 32.19                                    |                            |  |
| \$ 0.37-32.19            | 1,482,682                  | 6.76  | \$ 9.01                                  | 803,811                    | \$ 2.61                                  |

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**AEROVIRONMENT, INC.**

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

The remaining weighted average contractual life of exercisable options at April 30, 2009 was 5.79 years.

Information related to the Company's restricted stock awards at April 30, 2009 and for the year then ended is as follows:

|                                  | <b>2006 Plan</b> |   |
|----------------------------------|------------------|---|
|                                  | <b>Shares</b>    | <b>Weighted<br/>Average<br/>Grant<br/>Date<br/>Fair<br/>Value</b> |
| Unvested stock at April 30, 2008 |                  | \$  |
| Stock granted                    | 167,000          | 24.23   |
| Stock vested                     |                  |   |
| Stock canceled                   | (1,000)          | 32.52   |
| Unvested stock at April 30, 2009 | 166,000          | \$ 24.18  |

**12. Income Taxes**

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

|  | <b>Year Ended April 30,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2009</b>                 | <b>2008</b> | <b>2007</b> |
| U.S. federal statutory income tax rate               | 35.0%                       | 35.0%       | 35.0%       |
| State and local income taxes, net of federal benefit | 2.2                         | 3.8         | 5.4         |
| R&D credits  | (7.6)                       | (2.1)       | (3.9)       |
| Other  | (1.3)                       | (3.0)       | (0.8)       |
| Effective income tax rate                            | 28.3%                       | 33.7%       | 35.7%       |

The components of the provision for income taxes are as follows:

|                               | <b>Year ended April 30,</b> |             |             |
|-------------------------------|-----------------------------|-------------|-------------|
|                               | <b>2009</b>                 | <b>2008</b> | <b>2007</b> |
|                               | <b>(In thousands)</b>       |             |             |
| <b>Current:</b>               |                             |             |             |
| Federal                       | \$ 13,793                   | \$ 11,382   | \$ 7,066    |
| State                         | 471                         | 2,575       | 3,595       |
|                               | 14,264                      | 13,957      | 10,661      |
| <b>Deferred:</b>              |                             |             |             |
| Federal                       | (2,105)                     | (2,394)     | 18          |
| State                         | (2,600)                     | (710)       | 923         |
|                               | (4,705)                     | (3,104)     | 941         |
| Change in valuation allowance | (7)                         |             | (118)       |
| Total income tax expense      | \$ 9,552                    | \$ 10,853   | \$ 11,484   |



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:

|   | <b>April 30,</b>      |             |
|---|-----------------------|-------------|
|   | <b>2009</b>           | <b>2008</b> |
|   | <b>(In thousands)</b> |             |
| <b>Deferred income tax assets:</b>      |                       |             |
| Book over tax depreciation              | \$                    | \$ 1,203    |
| Accrued expenses                        | 4,468                 | 2,455       |
| Allowances, reserves, and other         | 1,453                 | 1,622       |
| Capital loss and credit carry-forwards  | 4,925                 | 398         |
|   | 10,846                | 5,678       |
| Less: valuation allowance               | (76)                  | (83)        |
| Total deferred income tax assets, net   | 10,770                | 5,595       |
| <b>Deferred income tax liabilities:</b> |                       |             |
| Tax over book depreciation              | (463)                 |             |
| Total deferred income tax liabilities   | (463)                 |             |
| Net deferred tax assets                 | \$ 10,307             | \$ 5,595    |

On May 1, 2007, the Company adopted the provisions of Interpretation No. 48, or FIN No. 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*. At April 30, 2009, the Company had approximately \$5,663,000 of unrecognized tax benefits all of which would impact the Company's effective tax rate if recognized. The Company estimates that \$603,000 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, 2009 and 2008:

|  | <b>April 30,</b>      |             |
|--|-----------------------|-------------|
|  | <b>2009</b>           | <b>2008</b> |
|  | <b>(In thousands)</b> |             |
| Balance as of May 1                                    | \$ 5,784              | \$ 5,356    |
| Increases related to prior year tax positions          | 619                   | 60          |
| Decreases related to prior year tax positions          | (491)                 |             |
| Increases related to current year tax positions        | 1,028                 | 678         |
| Decreases related to lapsing of statute of limitations | (1,277)               | (310)       |
| Balance as of April 30                                 | \$ 5,663              | \$ 5,784    |

The Company records interest and penalties on uncertain tax positions to income tax expense. As of April 30, 2009 and April 30, 2008, the Company had accrued approximately \$711,000 and \$441,000, 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 2006 to 2008 remain open to examination by the IRS for federal income taxes. The tax years 2004 to 2008 remain open for major state taxing jurisdictions.

Table of Contents**AEROVIRONMENT, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****13. Related Party Transactions**

Pursuant to a consulting agreement, the Company paid a board member approximately \$216,000, \$236,000 and \$245,000 during the years ended April 30, 2009, 2008 and 2007, respectively, for 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.

**14. Commitments and Contingencies****Commitments**

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

|            | <b>Year ending<br/>April 30<br/>(In<br/>thousands)</b> |
|------------|--|
| 2010       | \$ 3,234   |
| 2011       | 2,741  |
| 2012       | 2,539  |
| 2013       | 1,824  |
| 2014       | 1,713  |
| Thereafter | 427  |
|            | <b>\$ 12,478</b>                                       |

Rental expense under operating leases was approximately \$3,348,000, \$2,978,000 and \$2,331,000 for the years ended April 30, 2009, 2008 and 2007, respectively.

**Contingencies**

The Company is subject to legal proceedings and claims which arise out of the ordinary course of its business. Although occasional 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.

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.



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**AEROVIRONMENT, INC.**

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

**15. 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.

As discussed in Note 1, effective May 1, 2008, the Company consolidated the operations of two of its business segments to reflect the change in the management and organizational structure that occurred on May 1, 2008. The change in the management and organizational structure was made to take advantage of operational synergies and optimize management time by focusing on two as opposed to three business segments. PosiCharge Systems and Energy Technology Center were consolidated into one segment named Efficient Energy Systems. As required by SFAS No. 131, the Company has restated its historical segment information for the two years ended April 30, 2008, to be consistent with the current reportable segment structure. The consolidation of the two segments had no effect on the Company's financial position, results of operations or cash flows for the periods presented.

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.



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## AEROVIRONMENT, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The segment results are as follows:

|                                     | Year Ended April 30, |            |            |
|-------------------------------------|----------------------|------------|------------|
|                                     | 2009                 | 2008       | 2007       |
|                                     | (In thousands)       |            |            |
|                                     |                      | (Restated) | (Restated) |
| <b>Revenue:</b>                     |                      |            |            |
| UAS                                 | \$211,364            | \$186,615  | \$146,538  |
| EES                                 | 36,298               | 29,131     | 27,183     |
| Total                               | 247,662              | 215,746    | 173,721    |
| <b>Gross margin:</b>                |                      |            |            |
| UAS                                 | 70,968               | 68,598     | 57,591     |
| EES                                 | 17,629               | 9,949      | 10,891     |
| Total                               | 88,597               | 78,547     | 68,482     |
| Selling, general and administrative | 34,246               | 33,662     | 24,041     |
| Research and development            | 21,798               | 16,441     | 13,940     |
| Income from operations              | 32,553               | 28,444     | 30,501     |
| Interest income                     | 1,244                | 3,796      | 1,707      |
| Interest expense                    |                      | (1)        | (6)        |
| Income before income taxes          | \$ 33,797            | \$ 32,239  | \$ 32,202  |

**Geographic Information**

Sales to non-U.S. customers accounted for 7.0%, 6.1% and 4.6% of revenue for the fiscal years ended April 30, 2009, 2008 and 2007, respectively.

**16. 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, 2009. 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.

|                                      | Three Months Ended |                     |                     |                   |
|--------------------------------------|--------------------|---------------------|---------------------|-------------------|
|                                      | August 2,<br>2008  | November 1,<br>2008 | January 31,<br>2009 | April 30,<br>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 2009 do not equal the total earnings per share computed for the year due to rounding.

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## AEROVIRONMENT, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

|                                  | Three Months Ended                   |                     |                     |                   |
|----------------------------------|--------------------------------------|---------------------|---------------------|-------------------|
|                                  | July 28,<br>2007                     | October 27,<br>2007 | January 26,<br>2008 | April 30,<br>2008 |
|                                  | (In thousands except per share data) |                     |                     |                   |
| <b>Year ended April 30, 2008</b> |                                      |                     |                     |                   |
| Revenue                          | \$49,204                             | \$ 53,701           | \$ 48,535           | \$64,306          |
| Gross margin                     | \$ 16,837                            | \$ 18,927           | \$ 19,833           | \$22,950          |
| Net income                       | \$ 3,844                             | \$ 5,164            | \$ 5,965            | \$ 6,413          |
| Net income per share basic       | \$ 0.20                              | \$ 0.26             | \$ 0.30             | \$ 0.32           |
| Net income per share diluted     | \$ 0.18                              | \$ 0.24             | \$ 0.28             | \$ 0.30           |

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

| Description  | Balance<br>at<br>Beginning<br>of<br>Period | Additions                                 |                                    | Deductions | Balance<br>at<br>End of<br>Period |
|--|--|---|------------------------------------|------------|-----------------------------------|
|  |  | Charged<br>to<br>Costs<br>and<br>Expenses | Charged<br>to<br>Other<br>Accounts |            |                                   |
| (In thousands)   |  |   |                                    |            |                                   |
| Allowance for doubtful accounts for the year ended April 30:               |  |   |                                    |            |                                   |
| 2007   | \$ 86                                      | \$ 67                                     | \$                                 | \$ (4)     | \$ 149                            |
| 2008   | \$ 149                                     | \$ 71                                     | \$                                 | \$         | \$ 220                            |
| 2009   | \$ 220                                     | \$ 183                                    | \$                                 | \$ (112)   | \$ 291                            |
| Warranty reserve for the year ended April 30:                              |  |   |                                    |            |                                   |
| 2007   | \$ 344                                     | \$ 646                                    | \$                                 | \$ (727)   | \$ 263                            |
| 2008   | \$ 263                                     | \$ 844                                    | \$                                 | \$ (763)   | \$ 344                            |
| 2009   | \$ 344                                     | \$ 1,182                                  | \$                                 | \$ (1,003) | \$ 523                            |
| Reserve for inventory excess and obsolescence for the year ended April 30: |  |   |                                    |            |                                   |
| 2007   | \$ 813                                     | \$ 325                                    | \$                                 | \$         | \$ 1,138                          |
| 2008   | \$ 1,138                                   | \$ 455                                    | \$                                 | \$ (52)    | \$ 1,541                          |
| 2009   | \$ 1,541                                   | \$ 491                                    | \$                                 | \$ (643)   | \$ 1,389                          |

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**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, 2009, 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

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Commission (COSO). Based on this assessment, management concluded that the Company maintained effective internal control over financial reporting as of April 30, 2009 based on the specified criteria.

The effectiveness of our internal control over financial reporting as of April 30, 2009 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.**

Our board of directors approved the amendment of our bylaws effective June 18, 2009. The following sets forth a summary of the amendments, which is qualified in entirety by reference to our Second Amended and Restated Bylaws filed as Exhibit 3.3 hereto and incorporated by reference in this item.

**Article II Meetings of Stockholders**

**Section 12. Notice of Stockholder Business and Nominations.** The amended bylaws (a) expand the disclosure required by stockholders making proposals or nominations to include, among other things, with respect to the stockholder and any of its affiliates and associates, any derivative, swap or other transactions in our company and certain other material interests and relationships that could influence proposals or nominations, (b) require stockholders nominating directors to disclose the same information about proposed director nominees that would be required if the director nominee were submitting a proposal and require the director nominees to complete a questionnaire, representation and agreement with respect to their background, any voting commitments or compensation arrangements and their commitment to abide by our governance guidelines, (c) require a reasonably detailed description of all agreements, arrangements and understandings between stockholders making proposals of business and any other person or entity (including their names) in connection with the proposal of business, (d) require that disclosures provided by stockholders making proposals or nominations be updated and supplemented so as to be true and correct and (e) clarify that the provisions of this section apply to any proposal of business to be considered before a meeting of stockholders other than a stockholder proposal made pursuant to Rule 14a-8 under the Exchange Act.

**Article VI Certificates of Stock**

**Section 1. Form and Execution of Certificates.** The amended bylaws, consistent with the NASDAQ Stock Market Direct Registration System rules, clarify that our securities may be issued without certificates.

**Section 5. Transfers of Stock.** The amended bylaws, consistent with the NASDAQ Stock Market Direct Registration System rules, clarify that our securities may be issued without certificates.

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**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, 2009, 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, 2009, 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, 2009 and 2008, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended April 30, 2009 of AeroVironment, Inc. and subsidiaries and our report dated June 23, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California  
June 23, 2009

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**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 2009 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 2009 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 2009 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 2009 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 2009 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 2009 Annual Meeting of Stockholders, and that information is incorporated by reference herein.



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**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, 2009 and 2008

Consolidated Statements of Income for the Years ended April 30, 2009, 2008 and 2007

Consolidated Statements of Stockholders' Equity for the Years ended April 30, 2009, 2008 and 2007

Consolidated Statements of Cash Flows for the Years ended April 30, 2009, 2008 and 2007

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                   | Second Amended and Restated Bylaws of AeroVironment, Inc.  |
| 4.1(2)                | Form of AeroVironment, Inc.'s Common Stock Certificate   |
| 10.1#(2)              | Form of Director and Executive Officer Indemnification Agreement   |
| 10.2#(2)              | AeroVironment, Inc. Nonqualified Stock Option Plan   |
| 10.3#(2)              | Form of Nonqualified Stock Option Agreement pursuant to the AeroVironment, Inc. Nonqualified Stock Option Plan                       |
| 10.4#(2)              | AeroVironment, Inc. Directors' Nonqualified Stock Option Plan  |
| 10.5#(2)              | Form of Directors' Nonqualified Stock Option Agreement pursuant to the AeroVironment, Inc. Directors' Nonqualified Stock Option Plan |
| 10.6#(2)              | AeroVironment, Inc. 2002 Equity Incentive Plan   |

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- 10.7#(2) Form of AeroVironment, Inc. 2002 Equity Incentive Plan Stock Option Agreement
- 10.8#(2) AeroVironment, Inc. 2006 Equity Incentive Plan
- 10.9#(2) Form of Stock Option Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
- 10.10#(2) Form of Performance Based Bonus Award pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
- 10.11#(2) AeroVironment, Inc. Supplemental Executive Retirement Plan, dated May 19, 2005
- 10.12(2) 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

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| <b>Exhibit Number</b> | <b>Exhibit</b>  |
|-----------------------|---|
| 10.13(2)              | 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  |
| 10.14(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.   |
| 10.15(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.      |
| 10.16(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. |
| 10.17 (2)             | AV Direct Project Request, dated July 7, 2005, between AeroVironment, Inc. and Marine Corps System Command  |
| 10.18 (2)             | Award Contract, dated December 22, 2005, between AeroVironment, Inc. and Marine Corps System Command  |
| 10.19 (2)             | Award Contract, dated August 15, 2005, between AeroVironment, Inc. and U.S. Army Aviation & Missile Command   |
| 10.20 (2)             | Award Contract, dated September 21, 2004, between AeroVironment, Inc. and Natick Contracting Division   |
| 10.21 (2)             | Award Contract, dated January 2, 2004, between AeroVironment, Inc. and U.S. Army Aviation & Missile Command   |
| 10.22 (3)             | Award Contract, dated September 24, 2007, between AeroVironment, Inc. and United States Special Operations Command, as amended.   |
| 10.23 (4)             | Award Contract, dated December 22, 2006, between AeroVironment, Inc. and the United States Air Force/Air Force Research Laboratory, Aeronautical Systems Center, as amended.  |
| 10.24#                | Standard Consulting Agreement, dated November 1, 2008, between AeroVironment, Inc. and Charles R. Holland   |
| 10.25#(2)             | Retiree Medical Plan  |
| 10.26 (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  |

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- (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 to the Company's Registration Statement on Form S-1 (File No. 333-137658)
- (3) 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).
- (4) 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).
- (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).

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(7) 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.

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**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, 2009

/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 Stephen C. Wright, 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<br>_____<br>Timothy E. Conver     | Chairman, President and Chief<br>Executive Officer and Director<br>(Principal Executive Officer) | June 24,<br>2009 |
| /s/ STEPHEN C. WRIGHT<br>_____<br>Stephen C. Wright     | Chief Financial Officer (Principal<br>Financial and Accounting Officer)                          | June 24,<br>2009 |
| /s/ JOSEPH F. ALIBRANDI<br>_____<br>Joseph F. Alibrandi | Director   | June 24,<br>2009 |
| /s/ KENNETH R. BAKER<br>_____<br>Kenneth R. Baker       | Director   | June 24,<br>2009 |
| /s/ ARNOLD L. FISHMAN<br>_____<br>Arnold L. Fishman     | Director   | June 24,<br>2009 |
| /s/ CHARLES R. HOLLAND<br>_____<br>Charles R. Holland   | Director   | June 24,<br>2009 |