AeroVironment Inc
Form 10-Q
December 08, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 30, 2010

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-33261

AEROVIRONMENT, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-2705790**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
181 W. Huntington Drive, Suite 202 **Monrovia, California**	**91016**
(Address of principal executive offices)	(Zip Code)

(626) 357-9983

(Registrant s telephone number, including area code)

N/A

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

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 x No o

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

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

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

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

As of November 26, 2010, the number of shares outstanding of the registrant s common stock, $0.0001 par value, was 21,822,839.

Table of Contents

AeroVironment, Inc.

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AeroVironment, Inc.

Consolidated Balance Sheets

(In thousands except share and per share data)

		October 30, 2010 (Unaudited)		April 30, 2010
Assets				
Current assets:				
Cash and cash equivalents	$	76,664	$	28,665
Short-term investments		80,677		135,770
Accounts receivable, net of allowance for doubtful accounts of $993 at October 30, 2010 and $745 at April 30, 2010		33,299		38,645
Unbilled receivables and retentions		16,577		18,710
Inventories, net		28,929		20,928
Income tax receivable		2,321		
Deferred income taxes		1,237		956
Prepaid expenses and other current assets		2,285		1,921
Total current assets		241,989		245,595
Long-term investments		6,290		6,515
Property and equipment, net		18,047		20,025
Deferred income taxes		9,756		9,747
Other assets		125		89
Total assets	$	276,207	$	281,971
Liabilities and Stockholders Equity				
Current liabilities:				
Accounts payable	$	21,764	$	20,205
Wages and related accruals		11,854		10,336
Income taxes payable				6,507
Other current liabilities		5,912		4,473
Liability for uncertain tax positions		768		2,592
Total current liabilities		40,298		44,113
Deferred rent		1,151		1,268
Liability for uncertain tax positions		3,198		3,170
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 21,822,632 at October 30, 2010 and 21,732,413 at April 30, 2010		2		2

Additional paid-in capital		116,938		115,602
Accumulated other comprehensive loss		(775)		(760)
Retained earnings		115,395		118,576
Total stockholders equity		231,560		233,420
Total liabilities and stockholders equity	$	276,207	$	281,971

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

AeroVironment, Inc.

Consolidated Statements of Operations (Unaudited)

(In thousands except share and per share data)

	Three Months Ended		Six Months Ended	
	October 30, 2010	October 31, 2009	October 30, 2010	October 31, 2009
Revenue:				
Product sales	$ 32,494	$ 19,134	$ 44,714	$ 27,363
Contract services	31,287	32,233	57,295	61,944
	63,781	51,367	102,009	89,307
Cost of sales:				
Product sales	20,646	11,083	29,332	16,640
Contract services	21,360	20,635	38,866	42,303
	42,006	31,718	68,198	58,943
Gross margin	21,775	19,649	33,811	30,364
Selling, general and administrative	12,685	10,500	24,056	20,995
Research and development	8,689	5,776	16,661	11,449
Income (loss) from operations	401	3,373	(6,906)	(2,080)
Other income:				
Interest income	45	50	166	109
Income (loss) before income taxes	446	3,423	(6,740)	(1,971)
Provision (benefit) for income taxes	184	1,207	(3,559)	(600)
Net income (loss)	$ 262	$ 2,216	$ (3,181)	$ (1,371)
Earnings (loss) per share data:				
Basic	$ 0.01	$ 0.10	$ (0.15)	$ (0.06)
Diluted	$ 0.01	$ 0.10	$ (0.15)	$ (0.06)
Weighted average shares outstanding:				
Basic	21,565,969	21,348,325	21,555,864	21,332,379
Diluted	22,027,155	21,937,784	21,555,864	21,332,379

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

AeroVironment, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

	Six Months Ended October 30, 2010	Six Months Ended October 31, 2009
Operating activities		
Net loss	$ (3,181)	$ (1,371)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	5,493	4,156
Provision for doubtful accounts	248	21
Deferred income taxes	(280)	(215)
Stock-based compensation	1,077	845
Tax benefit from exercise of stock options	109	347
Excess tax benefit from stock-based compensation		(38)
(Gain) loss on sale of property and equipment	(56)	3
Changes in operating assets and liabilities:		
Accounts receivable	5,098	10,251
Unbilled receivables and retentions	2,133	154
Inventories	(8,001)	(13,504)
Income tax receivable	(2,351)	(902)
Other assets	(400)	(328)
Accounts payable	1,559	(8,234)
Other liabilities	(5,463)	425
Net cash and cash equivalents used in operating activities	(4,015)	(8,390)
Investing activities		
Acquisitions of property and equipment	(3,553)	(5,708)
Proceeds from the sale of property and equipment	94	
Net sales (purchases) of held-to-maturity investments	55,093	(4,974)
Net sales of available-for-sale investments	200	225
Net cash and cash equivalents provided by (used in) investing activities	51,834	(10,457)
Financing activities		
Excess tax benefit from stock-based compensation		38
Exercise of stock options	180	484
Net cash and cash equivalents provided by financing activities	180	522
Net increase (decrease) in cash and cash equivalents	47,999	(18,325)
Cash and cash equivalents at beginning of period	28,665	116,501
Cash and cash equivalents at end of period	$ 76,664	$ 98,176
Supplemental disclosure:		
Unrealized (losses) gains on long-term investments recorded in other comprehensive loss, net of deferred taxes of $10 and $45, respectively	$ (15)	$ 69

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

1. Organization and Significant Accounting Policies

Organization

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

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three and six months ended October 30, 2010 are not necessarily indicative of the results for the full year ending April 30, 2011. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended April 30, 2010, included in AeroVironment, Inc. s Annual Report on Form 10-K.

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

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

Segments

The Company s products are sold and divided among two reportable segments to reflect the Company s strategic goals. Operating segments are defined as components of an enterprise from which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker (CODM) in deciding how to allocate resources and in assessing performance. The Company s CODM is the Chief Executive

Officer, who reviews the revenue and gross margin results for each of these segments in order to make resource allocation decisions, including the focus of research and development, or R&D, activities and assessing performance. The Company s reportable segments are business units that offer different products and services and are managed separately.

Investments

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

Fair Values of Financial Instruments

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

Government Contracts

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

Table of Contents

AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

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

Earnings (Loss) Per Share

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

The reconciliation of diluted to basic shares is as follows:

	Three Months Ended		Six Months Ended	
	October 30, 2010	October 31, 2009	October 30, 2010	October 31, 2009
Denominator for basic earnings (loss) per share:				
Weighted average common shares outstanding, excluding unvested restricted stock	21,565,969	21,348,325	21,555,864	21,332,379
Dilutive effect of employee stock options and unvested restricted stock	461,186	589,459		
Denominator for diluted earnings (loss) per share	22,027,155	21,937,784	21,555,864	21,332,379

During the three months ended October 30, 2010 and October 31, 2009, certain options and shares of unvested restricted stock were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive. The number of options and shares of unvested restricted stock which met this anti-dilutive criterion for the three months ended October 30, 2010 and October 31, 2009 was approximately 16,000 and 900, respectively. Due to the net loss for the six months ended October 30, 2010 and October 31, 2009, no shares reserved for issuance upon exercise of stock options or shares of unvested restricted stock were included in the computation of diluted loss per share as their inclusion would have been anti-dilutive.

Recently Issued Accounting Standards

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

2. Investments

Investments consist of the following (in thousands):

	October 30, 2010	April 30, 2010
	(In thousands)	
Short-term investments:		
Held-to-maturity securities:		
U.S. Treasury bills	$ 80,677	$ 135,770
Total short-term investments	$ 80,677	$ 135,770
Long-term investments:		
Available-for-sale securities:		
Auction rate securities	$ 6,290	$ 6,515
Total long-term investments	$ 6,290	$ 6,515

Held-To-Maturity Securities

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

Table of Contents

AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury bills	$ 80,677	$ 10	$	$ 80,687
Total held-to-maturity investments	$ 80,677	$ 10	$	$ 80,687

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury bills	$ 135,770	$ 5	$ (3)	$ 135,772
Total held-to-maturity investments	$ 135,770	$ 5	$ (3)	$ 135,772

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

	Cost	Fair Value
Due within one year	$ 80,677	$ 80,687
Total	$ 80,677	$ 80,687

Available-For-Sale Securities

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

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

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

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

Table of Contents

AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Auction rate securities	$ 7,575	$	$ (1,285)	$ 6,290
Total available-for-sale investments	$ 7,575	$	$ (1,285)	$ 6,290

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Auction rate securities	$ 7,775	$	$ (1,260)	$ 6,515
Total available-for-sale investments	$ 7,775	$	$ (1,260)	$ 6,515

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

	Cost	Fair Value
Due after five through 10 years	$ 1,975	$ 1,762
Due after 10 years	5,600	4,528
Total	$ 7,575	$ 6,290

3. Inventories, net

Inventories consist of the following (in thousands):

	October 30, 2010	April 30, 2010
Raw materials	$ 8,480	$ 6,629

Work in process		9,676		6,336
Finished goods		12,526		9,154
Inventories, gross		30,682		22,119
Reserve for inventory obsolescence		(1,753)		(1,191)
Inventories, net	$	28,929	$	20,928

4. Fair Value Measurements

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

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

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

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

Table of Contents

AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

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

	Fair Value Measurement Using			
Description	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total**
Auction rate securities	$	$	$ 6,290	$ 6,290
Total	$	$	$ 6,290	$ 6,290

Due to the auction failures of the Company s auction rate securities that began in the fourth quarter of fiscal 2008, there are still no quoted prices in active markets for identical assets as of October 30, 2010. Therefore, the Company has classified its auction rate securities as Level 3 financial assets. The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis in the table above that used significant unobservable inputs (Level 3) (in thousands):

Description	**Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Securities**
Balance at April 30, 2010	$ 6,515
Transfers to Level 3	
Total gains (losses) (realized or unrealized)	
Included in earnings	
Included in other comprehensive loss	(25)
Settlements	(200)
Balance at October 30, 2010	$ 6,290
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 October 30, 2010	$

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

Based on the Company s ability to access its cash and cash equivalents, expected operating cash flows, and other sources of cash, the Company does not anticipate the current lack of liquidity on these investments will affect its ability to operate the business in the ordinary course. The Company believes the current lack of liquidity of these investments is temporary and expects that the securities will be redeemed or refinanced at some point in the future, allowing the Company to recover the original cost of $7.6 million. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible other-than-temporary impairment.

5. Other Comprehensive Income (Loss)

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

	Three Months Ended		Six Months Ended	
	October 30, 2010	October 31, 2009	October 30, 2010	October 31, 2009
Net income (loss)	$ 262	$ 2,216	$ (3,181)	$ (1,371)
Other comprehensive loss, net of tax:				
Unrealized losses on long-term investments	(29)	(37)	(15)	(69)
Comprehensive income (loss)	$ 233	$ 2,179	$ (3,196)	$ (1,440)

Table of Contents

AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

6. Warranty Reserves

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

	Three Months Ended		Six Months Ended	
	October 30, 2010	October 31, 2009	October 30, 2010	October 31, 2009
Beginning balance	$ 799	$ 579	$ 804	$ 523
Warranty expense	332	409	548	701
Warranty costs incurred	(297)	(402)	(518)	(638)
Ending balance	$ 834	$ 586	$ 834	$ 586

7. Customer-Funded Research & Development

Customer-funded R&D costs are incurred pursuant to contracts (revenue arrangements) to perform R&D activities according to customer specifications. These costs are direct contract costs and are expensed to cost of sales when the corresponding revenue is recognized, which is generally as the R&D services are performed. Revenue from customer-funded R&D was approximately $9.7 million and $21.6 million for the three and six months ended October 30, 2010, respectively. Revenue from customer-funded R&D was approximately $23.3 million and $47.8 million for the three and six months ended October 31, 2009, respectively.

8. Income Taxes

For the three and six months ended October 30, 2010, the Company recorded a provision (benefit) for income taxes of $0.2 million and ($3.6) million, respectively, yielding an effective tax rate of 41.3% and 52.8%, respectively. The variance from statutory rates for the three and six months ended October 30, 2010 was primarily due to a reduction in the liability for uncertain tax positions of approximately $1.7 million related to the conclusion of the examination of the Company s fiscal 2003 and 2004 tax returns. The examination concluded in May of 2010, and no change was required to the tax returns filed. For the three and six months ended October 31, 2009, the Company recorded a provision (benefit) for income taxes of $1.2 million and ($0.6) million, respectively, yielding an effective tax rate of 35.3% and 30.4%, respectively. The variance from statutory rates is primarily due to lower federal R&D tax credits.

9. Segment Data

The Company s product segments are as follows:

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

- Efficient Energy Systems (EES) The EES segment consists primarily of the design, development, production and support of system solutions for the electric transportation markets.

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

Table of Contents

AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

The segment results are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	October 30, 2010	October 31, 2009	October 30, 2010	October 31, 2009
Revenue:				
UAS	$ 53,616	$ 43,690	$ 87,063	$ 77,000
EES	10,165	7,677	14,946	12,307
Total	63,781	51,367	102,009	89,307
Gross margin:				
UAS	17,434	15,822	27,804	24,801
EES	4,341	3,827	6,007	5,563
Total	21,775	19,649	33,811	30,364
Selling, general and administrative	12,685	10,500	24,056	20,995
Research and development	8,689	5,776	16,661	11,449
Income (loss) from operations	401	3,373	(6,906)	(2,080)
Interest income	45	50	166	109
Income (loss) before income taxes	$ 446	$ 3,423	$ (6,740)	$ (1,971)

Table of Contents

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

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

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

Critical Accounting Policies and Estimates

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

There have been no material changes made to the critical accounting estimates during the periods presented in the consolidated financial statements from those disclosed in the Form 10-K for the fiscal year ended April 30, 2010.

Fiscal Periods

Due to our fixed year end date of April 30, our first and fourth quarters each consist of approximately 13 weeks. The second and third quarters each consist of exactly 13 weeks. Our first three quarters end on a Saturday. Our 2011 fiscal year ends on April 30, 2011 and our fiscal quarters end on July 31, 2010, October 30, 2010 and January 29, 2011.

Results of Operations

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

Table of Contents

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

Three Months Ended October 30, 2010 Compared to Three Months Ended October 31, 2009

	Three Months Ended	
	October 30, 2010	October 31, 2009
Revenue:		
UAS	$ 53,616	$ 43,690
EES	10,165	7,677
Total	63,781	51,367
Gross margin:		
UAS	17,434	15,822
EES	4,341	3,827
Total	21,775	19,649
Selling, general and administrative	12,685	10,500
Research and development	8,689	5,776
Income from operations	401	3,373
Interest income	45	50
Income before income taxes	$ 446	$ 3,423

Revenue. Revenue for the three months ended October 30, 2010 was $63.8 million, as compared to $51.4 million for the three months ended October 31, 2009, representing an increase of $12.4 million, or 24%. UAS revenue increased by $9.9 million to $53.6 million for the three months ended October 30, 2010, primarily due to an increase in UAS product deliveries of $11.7 million and service revenue of $11.2 million, partially offset by a decrease in customer-funded R&D work of $13.0 million. The increase in UAS product deliveries and service revenue was primarily due to increased deliveries of digital Puma® All Environment unmanned aircraft systems, or Puma AE systems, and retrofits of Raven B systems with our Digital Data Link, or DDL, technology. The decrease in customer-funded R&D work was primarily due to decreased activity on the Global Observer program. EES revenue increased by $2.5 million, or 32%, to $10.2 million for the three months ended October 30, 2010. The increase in EES revenue was primarily due to increased product deliveries of industrial electric vehicle charging systems.

Cost of Sales. Cost of sales for the three months ended October 30, 2010 was $42.0 million, as compared to $31.7 million for the three months ended October 31, 2009, representing an increase of $10.3 million, or 32%. The increase in cost of sales was caused primarily by increases in UAS cost of sales of $8.3 million and EES cost of sales of $2.0 million due to increased revenues.

Gross Margin. Gross margin for the three months ended October 30, 2010 was $21.8 million, as compared to $19.6 million for the three months ended October 31, 2009, representing an increase of $2.1 million, or 11%. UAS gross margin increased $1.6 million, or 10%, to $17.4 million for the three months ended October 30, 2010. As a percentage of revenue, gross margin for UAS decreased from 36% to 33%, primarily due to higher program costs and higher unabsorbed engineering overhead support costs. EES gross margin increased $0.5 million, or 13%, to $4.3 million for the three months ended October 30, 2010. As a percentage of revenue, EES gross margin decreased from 50% to 43%, primarily due to higher manufacturing overhead support costs to increase production capability and capacity.

Selling, General and Administrative. SG&A expense for the three months ended October 30, 2010 was $12.7 million, or 20% of revenue, compared to SG&A expense of $10.5 million, or 20% of revenue, for the three months ended October 31, 2009. SG&A expense increased $2.2

million primarily due to higher marketing and business development costs and higher administrative infrastructure costs.

Research and Development. R&D expense for the three months ended October 30, 2010 was $8.7 million, or 14% of revenue, compared to R&D expense of $5.8 million, or 11% of revenue, for the three months ended October 31, 2009. R&D expense increased $2.9 million primarily due to increased investment in various UAS and EES technology development initiatives.

Interest Income. Interest income for the three months ended October 30, 2010 and October 31, 2009 remained unchanged at $0.1 million.

Income Tax Expense. Our effective income tax rate was 41.3% for the three months ended October 30, 2010, as compared to 35.3% for the three months ended October 31, 2009. The increase was primarily due to the expiration of federal R&D tax credits.

Table of Contents

Six Months Ended October 30, 2010 Compared to Six Months Ended October 31, 2009

	Six Months Ended	
	October 30, 2010	October 31, 2009
Revenue:		
UAS	$ 87,063	$ 77,000
EES	14,946	12,307
Total	102,009	89,307
Gross margin:		
UAS	27,804	24,801
EES	6,007	5,563
Total	33,811	30,364
Selling, general and administrative	24,056	20,995
Research and development	16,661	11,449
Loss from operations	(6,906)	(2,080)
Interest income	166	109
Loss before income taxes	$ (6,740)	$ (1,971)

Revenue. Revenue for the six months ended October 30, 2010 was $102.0 million, as compared to $89.3 million for the six months ended October 31, 2009, representing an increase of $12.7 million, or 14%. UAS revenue increased $10.1 million, or 13%, to $87.1 million for the six months ended October 30, 2010, primarily due to increased UAS service revenue of $20.2 million and product deliveries of $15.4 million, partially offset by lower customer-funded R&D work of $25.5 million. The increase in UAS service revenue was primarily due to increased retrofits of Raven B systems with our DDL technology. The increase in product deliveries was primarily due to increased deliveries of Raven B and Puma AE systems with our DDL technology. The decrease in UAS customer-funded R&D revenue was primarily due to decreased activity on the Global Observer program. EES revenue increased by $2.6 million, or 21%, to $14.9 million for the six months ended October 30, 2010. The increase in EES revenue was primarily due to increased product deliveries of industrial electric vehicle charging systems.

Cost of Sales. Cost of sales for the six months ended October 30, 2010 was $68.2 million, as compared to $58.9 million for the six months ended October 31, 2009, representing an increase of $9.3 million, or 16%. The increase in cost of sales was caused by higher UAS cost of sales of $7.1 million and EES cost of sales of $2.2 million due to increased revenues.

Gross Margin. Gross margin for the six months ended October 30, 2010 was $33.8 million, as compared to $30.4 million for the six months ended October 31, 2009, representing an increase of $3.4 million, or 11%. UAS gross margin increased $3.0 million, or 12%, to $27.8 million for the six months ended October 30, 2010. As a percentage of revenue, gross margin for UAS remained unchanged at 32%. EES gross margin increased $0.4 million, or 8%, to $6.0 million for the six months ended October 30, 2010. As a percentage of revenue, EES gross margin decreased from 45% to 40%, due to higher manufacturing overhead support costs to increase production capability and capacity.

Selling, General and Administrative. SG&A expense for the six months ended October 30, 2010 was $24.1 million, or 24% of revenue, compared to SG&A expense of $21.0 million, or 24% of revenue, for the six months ended October 31, 2009. SG&A expense increased $3.1 million primarily due to higher marketing and business development costs and higher administrative infrastructure costs.

Research and Development. R&D expense for the six months ended October 30, 2010 was $16.7 million, or 16% of revenue, compared to R&D expense of $11.4 million, or 13% of revenue, for the six months ended October 31, 2009. The increase in R&D expense of $5.2 million was primarily due to increased investment in various UAS and EES technology development initiatives.

Interest Income. Interest income for the six months ended October 30, 2010 was $0.2 million, compared to $0.1 million for the six months ended October 31, 2009.

Income Tax Benefit. Our effective income tax rate was 52.8% for the six months ended October 30, 2010, as compared to 30.4% for the six months ended October 31, 2009. The increase in the effective tax rate was primarily due to a reduction in the liability for uncertain tax positions of approximately $1.7 million related to the conclusion of the examination of our fiscal 2003 and 2004 tax returns. The examination concluded in May of 2010, and no change was required to the tax returns filed.

Table of Contents

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 October 30, 2010 and April 30, 2010, our funded backlog was approximately $103.8 million and $72.3 million, respectively.

In addition to our funded backlog, we also had unfunded backlog of $205.6 million and $269.4 million as of October 30, 2010 and April 30, 2010, 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.

Liquidity and Capital Resources

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

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

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

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

Table of Contents

Cash Flows

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

	Six Months Ended October 30, 2010	Six Months Ended October 31, 2009
	(Unaudited)	
Net cash used in operating activities	$ (4,015)	$ (8,390)
Net cash provided by (used in) investing activities	$ 51,834	$ (10,457)
Net cash provided by financing activities	$ 180	$ 522

Cash Used in Operating Activities. Net cash used in operating activities for the six months ended October 30, 2010 decreased by $4.4 million to $4.0 million, compared to net cash used in operating activities of $8.4 million for the six months ended October 31, 2009. This decrease in net cash used in operating activities was primarily due to lower working capital needs of $4.7 million and higher depreciation of $1.3 million, partially offset by an increased loss of $1.8 million.

Cash Provided by Investing Activities. Net cash provided by investing activities increased by $62.3 million to $51.8 million for the six months ended October 30, 2010, compared to net cash used in investing activities of $10.5 million for the six months ended October 31, 2009. The increase in net cash provided by investing activities was primarily due to net sales of investments of $60.0 million and lower acquisitions of property and equipment of $2.2 million.

Cash Provided by Financing Activities. Net cash provided by financing activities decreased by $0.3 million to $0.2 million for the six months ended October 30, 2010, compared to $0.5 million for the six months ended October 31, 2009. During the three months ended October 30, 2010, we received proceeds from stock option exercises of $0.2 million.

Off-Balance Sheet Arrangements

During the second quarter, there were no material changes in our off balance sheet arrangements or contractual obligations and commercial commitments from those disclosed in the Form 10-K for the fiscal year ended April 30, 2010.

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the ordinary course of business, we are exposed to various market risk factors, including fluctuations in interest rates, changes in general economic conditions, domestic and foreign competition, and foreign currency exchange rates.

Interest Rate Risk

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

Foreign Currency Exchange Rate Risk

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

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures.

Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective and were operating at a reasonable assurance level.

Internal Control over Financial Reporting

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed under Part I, Item 1A, Risk Factors, in our Annual Report on Form 10-K for the fiscal year ended April 30, 2010. Please refer to that section for disclosures regarding the risks and uncertainties related to our business.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit Number	Description
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: December 7, 2010

AEROVIRONMENT, INC.

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

/s/ Jikun Kim
Jikun Kim
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)