

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**For the quarterly period ended January 31, 2009**

0 **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)

(Address of principal executive offices)

(Zip Code)

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(Registrant's telephone number, including area code)

N/A

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

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

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

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

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

As of February 25, 2009, the number of shares outstanding of the registrant's common stock, \$0.0001 par value, was 21,328,387.

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**AeroVironment, Inc.**

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|  | <b>January 31,<br/>2009<br/>(Unaudited)</b> | <b>April 30,<br/>2008</b> |
|--|---|---------------------------|
| <b>Assets</b>  |   |                           |
| Current assets:  |   |                           |
| Cash and cash equivalents  | \$ 101,938                                  | \$ 105,064                |
| Short-term investments   | 21,514                                      | 13,375                    |
| Accounts receivable, net of allowance for doubtful accounts of \$395 at January 31, 2009 and \$220 at April 30, 2008 | 30,078                                      | 29,788                    |
| Unbilled receivables and retentions  | 23,104                                      | 20,590                    |
| Inventories, net   | 20,379                                      | 15,923                    |
| Income tax receivable  | 3,043                                       |                           |
| Deferred income taxes  | 3,064                                       | 2,810                     |
| Prepaid expenses and other current assets  | 1,014                                       | 2,014                     |
| Total current assets   | 204,134                                     | 189,564                   |
| Long-term investments  | 7,136                                       |                           |
| Property and equipment, net  | 15,587                                      | 10,308                    |
| Deferred income taxes  | 3,150                                       | 2,785                     |
| Other assets   | 102   | 122                       |
| Total assets   | \$ 230,109                                  | \$ 202,779                |
| <b>Liabilities and Stockholders' Equity</b>  |   |                           |
| Current liabilities:   |   |                           |
| Accounts payable   | \$ 15,728                                   | \$ 14,080                 |
| Wages and related accruals   | 8,404                                       | 10,428                    |
| Income taxes payable   |   | 3,804                     |
| Other current liabilities  | 4,040                                       | 3,786                     |
| Total current liabilities  | 28,172                                      | 32,098                    |
| Deferred rent  | 1,386                                       | 941                       |
| 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  |   |                           |
|  | 2   | 2                         |

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Issued and outstanding shares 21,295,073 at January 31, 2009 and 20,614,044 at April 30, 2008

|  |            |            |
|--|------------|------------|
| Additional paid-in capital                 | 109,074    | 96,123     |
| Accumulated other comprehensive loss       | (549)      |            |
| Retained earnings                          | 92,024     | 73,615     |
| Total stockholders' equity                 | 200,551    | 169,740    |
| Total liabilities and stockholders' equity | \$ 230,109 | \$ 202,779 |

See accompanying notes to consolidated financial statements (unaudited).

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

|                                      | <b>Three Months Ended</b> |                    | <b>Nine Months Ended</b> |                    |
|--------------------------------------|---------------------------|--------------------|--------------------------|--------------------|
|                                      | <b>January 31,</b>        | <b>January 26,</b> | <b>January 31,</b>       | <b>January 26,</b> |
|                                      | <b>2009</b>               | <b>2008</b>        | <b>2009</b>              | <b>2008</b>        |
| Revenue:                             |                           |                    |                          |                    |
| Product sales                        | \$ 30,160                 | \$ 19,947          | \$ 92,746                | \$ 83,673          |
| Contract services                    | 22,065                    | 28,588             | 78,871                   | 67,767             |
|                                      | 52,225                    | 48,535             | 171,617                  | 151,440            |
| Cost of sales:                       |                           |                    |                          |                    |
| Product sales                        | 18,682                    | 9,585              | 55,485                   | 48,487             |
| Contract services                    | 16,866                    | 19,117             | 53,885                   | 47,356             |
|                                      | 35,548                    | 28,702             | 109,370                  | 95,843             |
| Gross margin                         | 16,677                    | 19,833             | 62,247                   | 55,597             |
| Selling, general and administrative  | 7,950                     | 8,216              | 23,900                   | 24,515             |
| Research and development             | 4,625                     | 3,664              | 14,781                   | 11,766             |
| Income from operations               | 4,102                     | 7,953              | 23,566                   | 19,316             |
| Other income:                        |                           |                    |                          |                    |
| Interest income                      | 197                       | 1,011              | 1,107                    | 3,133              |
| Income before income taxes           | 4,299                     | 8,964              | 24,673                   | 22,449             |
| (Benefit) provision for income taxes | (242)                     | 2,999              | 6,264                    | 7,476              |
| Net income                           | \$ 4,541                  | \$ 5,965           | \$ 18,409                | \$ 14,973          |
| Earnings per share data:             |                           |                    |                          |                    |
| Basic                                | \$ 0.21                   | \$ 0.30            | \$ 0.88                  | \$ 0.77            |
| Diluted                              | \$ 0.21                   | \$ 0.28            | \$ 0.84                  | \$ 0.70            |
| Weighted average shares outstanding: |                           |                    |                          |                    |
| Basic                                | 21,147,902                | 20,141,903         | 20,937,284               | 19,568,819         |
| Diluted                              | 22,030,603                | 21,517,117         | 21,940,482               | 21,320,241         |

See accompanying notes to consolidated financial statements (unaudited).

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**AeroVironment, Inc.**
**Consolidated Statements of Cash Flows (Unaudited)**

(In thousands)

|   | <b>Nine Months Ended</b>    |                             |
|---|-----------------------------|-----------------------------|
|   | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> |
| <b>Operating activities</b>   |                             |                             |
| Net income  | \$ 18,409                   | \$ 14,973                   |
| Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities:                  |                             |                             |
| Depreciation and amortization   | 3,622                       | 2,612                       |
| Provision for doubtful accounts   | 175                         | (37)                        |
| Deferred income taxes   | (254)                       | (113)                       |
| Stock-based compensation  | 637                         | 330                         |
| Tax benefit from exercise of stock options  | 11,335                      | 10,871                      |
| Gain on sale of property and equipment  | (5)                         |                             |
| Changes in operating assets and liabilities:  |                             |                             |
| Accounts receivable   | (465)                       | (17,735)                    |
| Unbilled receivables and retentions   | (2,514)                     | 8,076                       |
| Inventories   | (4,456)                     | (2,955)                     |
| Income tax receivable   | (3,043)                     | (2,623)                     |
| Other assets  | 1,020                       | (115)                       |
| Accounts payable  | 1,648                       | (3,382)                     |
| Other liabilities   | (5,129)                     | (3,075)                     |
| Net cash and cash equivalents provided by operating activities  | 20,980                      | 6,827                       |
| <b>Investing activities</b>   |                             |                             |
| Acquisitions of property and equipment  | (8,905)                     | (6,639)                     |
| Proceeds from sale of property and equipment  | 9                           |                             |
| Net (purchases) sales of investments  | (16,189)                    | 57,545                      |
| Net cash and cash equivalents (used in) provided by investing activities  | (25,085)                    | 50,906                      |
| <b>Financing activities</b>   |                             |                             |
| Transfers to restricted cash  |                             | (17)                        |
| Exercise of stock options   | 979                         | 929                         |
| Net cash and cash equivalents provided by financing activities  | 979                         | 912                         |
| Net (decrease) increase in cash and cash equivalents  | (3,126)                     | 58,645                      |
| Cash and cash equivalents at beginning of period  | 105,064                     | 20,920                      |
| Cash and cash equivalents at end of period  | \$ 101,938                  | \$ 79,565                   |
| <b>Supplemental disclosure:</b>   |                             |                             |
| Unrealized losses on long-term investments recorded in other comprehensive income, net of deferred tax benefit of \$365 | \$ (549)                    | \$                          |

See accompanying notes to consolidated financial statements (unaudited).





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**AeroVironment, Inc.**

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

**1. Organization and Significant Accounting Policies**

***Organization***

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

***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three and nine months ended January 31, 2009 are not necessarily indicative of the results for the full year ending April 30, 2009. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended April 30, 2008, included in AeroVironment, Inc.'s Annual Report on Form 10-K.

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

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

***Segments***

The Company's products are sold and divided among two reportable segments, 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

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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.

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 was implemented 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 three and nine months ended January 26, 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.

### ***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. As of January 31, 2009, the Company's short-term investments consisted primarily of U.S. treasury bills and are reported at amortized cost. The long-term investments consist entirely of auction rate securities and are reported at fair value.

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**AeroVironment, Inc.**

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

***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.

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

***Earnings Per Share***

Basic earnings per share is computed using the weighted-average number of common shares outstanding, excluding 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 unvested restricted stock.

The reconciliation of diluted to basic shares is as follows:

|   | <b>Three Months Ended</b>   |                             | <b>Nine Months Ended</b>    |                             |
|---|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|   | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> |
| Denominator for basic earnings per share:                                       |                             |                             |                             |                             |
| Weighted average common shares outstanding, excluding unvested restricted stock | 21,147,902                  | 20,141,903                  | 20,937,284                  | 19,568,819                  |
| Dilutive effect of employee stock options and unvested restricted stock         | 882,701                     | 1,375,214                   | 1,003,198                   | 1,751,422                   |
| Denominator for diluted earnings per share                                      | 22,030,603                  | 21,517,117                  | 21,940,482                  | 21,320,241                  |

During the three and nine months ended January 31, 2009 and January 26, 2008 certain options and 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 unvested restricted stock which met this anti-dilutive criterion was approximately 11,000 and 19,000 for the three and nine months ended January 31, 2009, respectively. The number of options which met this anti-dilutive criterion was approximately 76,000 and 194,000 for the three and nine

months ended January 26, 2008, respectively.

***Recently Issued 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 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.

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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 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 is the year 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.

**2. Inventories, net**

Inventories consist of the following (in thousands):

|                                    | <b>January 31,<br/>2009</b> | <b>April 30,<br/>2008</b> |
|------------------------------------|-----------------------------|---------------------------|
| Raw materials                      | \$ 8,518                    | \$ 6,855                  |
| Work in process                    | 6,154                       | 4,958                     |
| Finished goods                     | 6,889                       | 5,651                     |
| Inventories, gross                 | 21,561                      | 17,464                    |
| Reserve for inventory obsolescence | (1,182)                     | (1,541)                   |
| Inventories, net                   | \$ 20,379                   | \$ 15,923                 |

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

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS No. 157 at January 31, 2009, were as follows (in thousands):

| Description               | Fair Value Measurement Using  |   |  | Total             |
|---------------------------|---|---|--|-------------------|
|                           | Quoted prices in<br>active markets<br>for identical 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 | \$ 101,938  | \$  | \$   | \$ 101,938        |
| Auction rate securities   |   |   | 7,136  | 7,136             |
| <b>Total</b>              | <b>\$ 101,938</b>   | <b>\$</b>   | <b>\$ 7,136</b>                                    | <b>\$ 109,074</b> |

Due to the auction failures of the Company's auction rate securities that began in the fourth quarter of fiscal 2008, there are still no quoted prices in active markets for identical assets as of January 31, 2009. 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):

**Fair Value  
Measurements Using  
Significant  
Unobservable Inputs  
(Level 3)**

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| Description  | Auction Rate 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   | (914)                   |
| Purchases, issuances and settlements, net  | (5,325)                 |
| Balance at January 31, 2009  | \$ 7,136                |
| The amount of total gains or (losses) for the period included in earnings (or change in net assets)        |                         |
| attributable to the change in unrealized gains or losses relating to assets still held at January 31, 2009 | \$                      |

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**AeroVironment, Inc.**

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

The auction rate securities are valued using a discounted cash flow model. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the 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, allowing the Company to recover the original cost of \$8.0 million. In prior periods, the Company classified its auction rate securities as current assets. However, due to financial market conditions, these investments have been reclassified as long-term investments as of November 1, 2008. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible other than temporary impairment.

**4. Other Comprehensive Income**

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

|  | <b>Three Months Ended</b>   |                             | <b>Nine Months Ended</b>    |                             |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|  | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> |
| Net income                               | \$ 4,541                    | \$ 5,965                    | \$ 18,409                   | \$ 14,973                   |
| Other comprehensive loss, net of tax:    |                             |                             |                             |                             |
| Unrealized loss on long-term investments | (549)                       |                             | (549)                       |                             |
| Comprehensive income                     | \$ 3,992                    | \$ 5,965                    | \$ 17,860                   | \$ 14,973                   |

**5. Warranty Reserves**

The warranty reserve is included in other current liabilities. The related expense is included in cost of sales. Warranty reserve activity is summarized as follows for the three and nine months ended January 31, 2009 and January 26, 2008 (in thousands):

|                   | <b>Three Months Ended</b>   |                             | <b>Nine Months Ended</b>    |                             |
|-------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                   | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> |
| Beginning balance | \$ 399                      | \$ 382                      | \$ 344                      | \$ 263                      |



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|                         |    |       |    |       |    |       |    |       |
|-------------------------|----|-------|----|-------|----|-------|----|-------|
| Warranty expense        |    | 295   |    | 123   |    | 772   |    | 594   |
| Warranty costs incurred |    | (194) |    | (218) |    | (616) |    | (570) |
| Ending balance          | \$ | 500   | \$ | 287   | \$ | 500   | \$ | 287   |

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**AeroVironment, Inc.**

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

**6. Stock-Based Compensation**

For the three and nine months ended January 31, 2009 the Company recorded stock-based compensation of approximately \$233,000 and \$637,000, respectively. For the three and nine months ended January 26, 2008, the Company recorded stock-based compensation of approximately \$145,000 and \$330,000, respectively.

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 three and nine months ended January 31, 2009 and January 26, 2008:

|   | <b>Three Months Ended</b>   |                             | <b>Nine Months Ended</b>    |                             |
|---|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|   | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> | <b>January 31,<br/>2009</b> | <b>January 26,<br/>2008</b> |
| Expected term (in years)                  |                             | 6.5                         | 6.5                         | 6.5                         |
| Expected volatility                       |                             | 18.81%                      | 18.43%                      | 19.52%                      |
| Risk-free interest rate                   |                             | 3.55%                       | 3.58%                       | 4.67%                       |
| Expected dividend                         |                             |                             |                             |                             |
| Weighted average fair value at grant date | \$                          | \$ 7.01                     | \$ 9.33                     | \$ 7.55                     |

There were no options granted during the three months ended January 31, 2009.

The expected term of stock options represents the weighted average period the Company expects the stock options to remain outstanding, using a midpoint model 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), *Share Based Payment*. 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.

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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.

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

Information related to the Company's stock option plans at January 31, 2009 and for the three and nine months then ended is as follows:

|   | <b>2006 Plan</b> |  | <b>2002 Plan</b> |  | <b>1992 Plan</b> |  |
|---|------------------|--|------------------|--|------------------|--|
|   | <b>Shares</b>    | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Shares</b>    | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Shares</b>    | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> |
| Outstanding at April 30, 2008           | 379,310          | \$ 21.86   | 1,077,477        | \$ 2.20  | 626,895          | \$ 0.49  |
| Options granted                         | 55,000           | 32.19  |                  |  |                  |  |
| Options exercised                       | (3,000)          | 20.75  | (214,796)        | 0.79   | (48,416)         | 0.52   |
| Options canceled                        | (10,000)         | 24.09  | (11,965)         | 6.20   |                  |  |
| Outstanding at August 2, 2008           | 421,310          | \$ 23.17   | 850,716          | \$ 2.50  | 578,479          | \$ 0.49  |
| Options granted                         |                  |  |                  |  |                  |  |
| Options exercised                       | (4,900)          | 20.36  | (111,202)        | 1.64   | (62,864)         | 0.47   |
| Options canceled                        | (12,000)         | 20.75  | (1,408)          | 0.78   |                  |  |
| Outstanding at November 1, 2008         | 404,410          | \$ 23.27   | 738,106          | \$ 2.63  | 515,615          | \$ 0.49  |
| Options granted                         |                  |  |                  |  |                  |  |
| Options exercised                       | (12,200)         | 21.90  | (81,610)         | 1.17   | (95,041)         | 0.53   |
| Options canceled                        |                  |  |                  |  |                  |  |
| Outstanding at January 31, 2009         | 392,210          | \$ 23.31   | 656,496          | \$ 2.81  | 420,574          | \$ 0.49  |
| Options exercisable at January 31, 2009 | 50,362           | \$ 21.96   | 385,883          | \$ 2.03  | 420,574          | \$ 0.49  |

Information related to the Company's restricted stock awards at January 31, 2009 and for the three and nine months then ended is as follows:

|                                    | <b>Shares</b> | <b>2006 Plan<br/>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|------------------------------------|---------------|---|
| Unvested stock at April 30, 2008   |               | \$  |
| Stock granted                      | 44,000        | 32.52   |
| Stock vested                       |               |   |
| Stock canceled                     |               |   |
| Unvested stock at August 2, 2008   | 44,000        | \$ 32.52  |
| Stock granted                      |               |   |
| Stock vested                       |               |   |
| Stock canceled                     | (1,000)       | 32.52   |
| Unvested stock at November 1, 2008 | 43,000        | \$ 32.52  |

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|                                    |        |    |       |
|------------------------------------|--------|----|-------|
| Stock granted                      | 4,000  |    | 30.88 |
| Stock vested                       |        |    |       |
| Stock canceled                     |        |    |       |
| Unvested stock at January 31, 2009 | 47,000 | \$ | 32.38 |

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**AeroVironment, Inc.**

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

**7. Customer Funded Research & Development**

Customer-funded R&D costs are incurred pursuant to contracts (revenue arrangements) to perform R&D activities according to customer specifications. These costs are direct contract costs and are expensed to cost of sales when the corresponding revenue is recognized, which is generally as the R&D services are performed. Revenue from customer-funded R&D was approximately \$16,844,000 and \$45,917,000 for the three and nine months ended January 31, 2009, respectively. Revenue from customer-funded R&D was approximately \$6,892,000 and \$16,995,000 for the three and nine months ended January 26, 2008, respectively.

**8. Income Taxes**

For the three and nine months ended January 31, 2009, the Company recorded provisions for income taxes of (\$242,000) and \$6,264,000, respectively, yielding an effective tax rate of (5.6%) and 25.4%, respectively. The variance from statutory rates is primarily due to R&D tax credits related to fiscal 2009 and the recognition of previously unrecognized tax benefits of \$1,277,000 related to R&D tax credits earned in prior fiscal years. The unrecognized tax benefits of \$1,277,000 were recorded in the current quarter due to the expiration of the applicable statute of limitations, in January of 2009, for the audit period for the tax return containing the unrecognized tax benefits.

**9. Segment Data**

The Company's product segments are as follows:

- Unmanned Aircraft Systems ( UAS ) The UAS segment consists primarily of the design, development, production and support of unmanned aircraft systems solutions.
- Efficient Energy Systems ( EES ) The EES segment consists primarily of the design, development, production and support of system solutions for the clean transportation and clean energy markets.

As discussed in Note 1, effective May 1, 2008, the Company consolidated the operations of two of its business segments to reflect the current 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 three and nine months ended January 26, 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 Consolidated Financial Statements (Unaudited)**

The segment results are as follows (in thousands):

|                                     | <b>Three Months Ended</b> |                    | <b>Nine Months Ended</b> |                    |
|-------------------------------------|---------------------------|--------------------|--------------------------|--------------------|
|                                     | <b>January 31,</b>        | <b>January 26,</b> | <b>January 31,</b>       | <b>January 26,</b> |
|                                     | <b>2009</b>               | <b>2008</b>        | <b>2009</b>              | <b>2008</b>        |
|                                     |                           | <b>(Restated)</b>  |                          | <b>(Restated)</b>  |
| Revenue:                            |                           |                    |                          |                    |
| UAS                                 | \$ 43,394                 | \$ 42,162          | \$ 145,926               | \$ 130,639         |
| EES                                 | 8,831                     | 6,373              | 25,691                   | 20,801             |
| Total                               | 52,225                    | 48,535             | 171,617                  | 151,440            |
| Gross margin:                       |                           |                    |                          |                    |
| UAS                                 | 13,461                    | 17,489             | 50,050                   | 48,490             |
| EES                                 | 3,216                     | 2,344              | 12,197                   | 7,107              |
| Total                               | 16,677                    | 19,833             | 62,247                   | 55,597             |
| Selling, general and administrative | 7,950                     | 8,216              | 23,900                   | 24,515             |
| Research and development            | 4,625                     | 3,664              | 14,781                   | 11,766             |
| Income from operations              | 4,102                     | 7,953              | 23,566                   | 19,316             |
| Interest income                     | 197                       | 1,011              | 1,107                    | 3,133              |
| Income before income taxes          | \$ 4,299                  | \$ 8,964           | \$ 24,673                | \$ 22,449          |



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

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

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

**Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. When we prepare these consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Some of our accounting policies require that we make subjective judgments, including estimates that involve matters that are inherently uncertain. Our most critical estimates include those related to 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.

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, 2008.

**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 2009 fiscal year ends on April 30, 2009 and our fiscal quarters end on August 2, 2008, November 1, 2008 and January 31, 2009.

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## Results of Operations

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

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

### Three Months Ended January 31, 2009 Compared to Three Months Ended January 26, 2008

|                                     | Three Months Ended  |                                   |
|-------------------------------------|---------------------|-----------------------------------|
|                                     | January 31,<br>2009 | January 26,<br>2008<br>(Restated) |
| Revenue:                            |                     |                                   |
| UAS                                 | \$ 43,394           | \$ 42,162                         |
| EES                                 | 8,831               | 6,373                             |
| Total                               | 52,225              | 48,535                            |
| Gross margin:                       |                     |                                   |
| UAS                                 | 13,461              | 17,489                            |
| EES                                 | 3,216               | 2,344                             |
| Total                               | 16,677              | 19,833                            |
| Selling, general and administrative | 7,950               | 8,216                             |
| Research and development            | 4,625               | 3,664                             |
| Income from operations              | 4,102               | 7,953                             |
| Interest income                     | 197                 | 1,011                             |
| Income before income taxes          | \$ 4,299            | \$ 8,964                          |

**Revenue.** Revenue for the three months ended January 31, 2009 was \$52.2 million, as compared to \$48.5 million for the three months ended January 26, 2008, representing an increase of \$3.7 million, or 8%. UAS revenue increased \$1.2 million, or 3%, to \$43.4 million for the three months ended January 31, 2009, primarily due to increased UAS customer-funded R&D work of \$10.0 million and product deliveries of \$7.8 million, partially offset by lower service revenue of \$16.5 million. The increase in UAS customer-funded R&D work and product deliveries was primarily due to increased activity on the Global Observer contract and product deliveries to international customers, respectively. The decrease in service revenue was primarily due to higher revenue in the prior year for the retrofit of Raven A systems to Raven B systems, which did not occur in the current quarter. EES revenue increased by \$2.5 million, or 39%, to \$8.8 million for the three months ended January 31, 2009. The increase in EES revenue was primarily due to increased deliveries of Electric Vehicle ( EV ) test systems.

**Cost of Sales.** Cost of sales for the three months ended January 31, 2009 was \$35.5 million, as compared to \$28.7

million for the three months ended January 26, 2008, representing an increase of \$6.8 million, or 24%. The increase in cost of sales was caused primarily by higher UAS cost of sales of \$5.2 million and EES cost of sales of \$1.6 million.

**Gross Margin.** Gross margin for the three months ended January 31, 2009 was \$16.7 million, as compared to \$19.8 million for the three months ended January 26, 2008, representing a decrease of \$3.1 million, or 16%. UAS gross margin decreased \$4.0 million, or 23%, to \$13.5 million for the three months ended January 31, 2009. As a percentage of revenue, gross margin for UAS decreased from 41% to 31% largely due to lower revenue on cost-type government contracts due to reduced indirect rate application; and higher program costs. EES gross margin increased \$0.9 million, or 37%, to \$3.2 million for the three months ended January 31, 2009. As a percentage of revenue, EES gross margin decreased from 37% to 36%.

**Selling, General and Administrative.** SG&A expense for the three months ended January 31, 2009 was \$7.9 million, or 15% of revenue, compared to SG&A expense of \$8.2 million, or 17% of revenue, for the three months ended January 26, 2008. SG&A expense decreased \$0.3 million primarily due to lower selling costs.

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**Research and Development.** R&D expense for the three months ended January 31, 2009 was \$4.6 million, or 9% of revenue, which was higher than R&D expense of \$3.7 million, or 8% of revenue, for the three months ended January 26, 2008. R&D expense increased \$0.9 million largely due to increased investment in various development initiatives for UAS.

**Income Tax Expense.** Our effective income tax rate was (5.6%) for the three months ended January 31, 2009, as compared to 33.5% for the three months ended January 26, 2008. The decrease was primarily due to the recognition of previously unrecognized tax benefits of \$1.3 million related to R&D tax credits earned in prior fiscal years. The unrecognized tax benefits of \$1.3 million were recorded in the current quarter due to the expiration of the applicable statute of limitations, in January of 2009, for the audit period for the tax return containing the unrecognized tax benefits.

## Nine Months Ended January 31, 2009 Compared to Nine Months Ended January 26, 2008

|                                     | Nine Months Ended   |                                   |
|-------------------------------------|---------------------|-----------------------------------|
|                                     | January 31,<br>2009 | January 26,<br>2008<br>(Restated) |
| Revenue:                            |                     |                                   |
| UAS                                 | \$ 145,926          | \$ 130,639                        |
| EES                                 | 25,691              | 20,801                            |
| Total                               | 171,617             | 151,440                           |
| Gross margin:                       |                     |                                   |
| UAS                                 | 50,050              | 48,490                            |
| EES                                 | 12,197              | 7,107                             |
| Total                               | 62,247              | 55,597                            |
| Selling, general and administrative | 23,900              | 24,515                            |
| Research and development            | 14,781              | 11,766                            |
| Income from operations              | 23,566              | 19,316                            |
| Interest income                     | 1,107               | 3,133                             |
| Income before income taxes          | \$ 24,673           | \$ 22,449                         |

**Revenue.** Revenue for the nine months ended January 31, 2009 was \$171.6 million, as compared to \$151.4 million for the nine months ended January 26, 2008, representing an increase of \$20.2 million, or 13%. UAS revenue increased \$15.3 million, or 12%, to \$145.9 million for the nine months ended January 31, 2009, primarily due to increased UAS customer-funded R&D of \$28.7 million and higher product deliveries of \$5.0 million, partially offset by lower service revenue of \$18.5 million. The increase in UAS customer-funded R&D was primarily due to increased activity on the Global Observer contract. The decrease in service revenue was primarily due to higher revenue in the prior year for the retrofit of Raven A systems to Raven B systems, which did not occur in the current nine months. EES revenue increased by \$4.9 million, or 24%, to \$25.7 million for the nine months ended January 31, 2009. The increase in EES revenue was primarily due to increased deliveries of EV test systems.

**Cost of Sales.** Cost of sales for the nine months ended January 31, 2009 was \$109.4 million, as compared to \$95.8 million for the nine months ended January 26, 2008, representing an increase of \$13.6 million, or 14%. The increase in cost of sales was caused primarily by higher UAS cost of sales of \$13.8 million partially offset by lower EES cost of sales of \$0.2 million.

**Gross Margin.** Gross margin for the nine months ended January 31, 2009 was \$62.2 million, as compared to \$55.6 million for the nine months ended January 26, 2008, representing an increase of \$6.6 million, or 12%. UAS gross margin increased \$1.6 million, or 3%, to \$50.1 million for the nine months ended January 31, 2009. As a percentage of revenue, gross margin for UAS decreased from 37% to 34% primarily due to higher program costs. EES gross margin increased \$5.1 million, or 72% to \$12.2 million for the nine months ended January 31, 2009. As a percentage of revenue, EES gross margin increased from 34% to 47%, primarily due to operating improvements and changes in product mix.

**Selling, General and Administrative.** SG&A expense for the nine months ended January 31, 2009 was \$23.9 million, or 14% of revenue, compared to SG&A expense of \$24.5 million, or 16% of revenue, for the nine months ended January 26, 2008. SG&A expense decreased \$0.6 million primarily due to lower bid and proposal costs.

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**Research and Development.** R&D expense for the nine months ended January 31, 2009 was \$14.8 million, or 9% of revenue, which was higher than R&D expense of \$11.8 million, or 8% of revenue, for the nine months ended January 26, 2008. R&D expense increased \$3.0 million primarily due to increased investment in various development initiatives for UAS.

**Income Tax Expense.** Our effective income tax rate was 25.4% for the nine months ended January 31, 2009, as compared to 33.3% for the nine months ended January 26, 2008. This decrease was caused primarily by the renewal of the federal R&D tax credit, which had expired in December 2007 and recognition of previously unrecognized tax benefits of \$1.3 million related to R&D tax credits earned in prior fiscal years. The renewal of the R&D tax credit allowed us to recapture the unused portion of the credit from January 1, 2008 through April 30, 2008. The unrecognized tax benefits of \$1.3 million were recorded due to the expiration of the applicable statute of limitations, in January of 2009, for the audit period for the tax return containing the unrecognized tax benefits.

**Backlog.** We define funded backlog as unfilled firm orders for products and services for which funding currently is appropriated to us under the contract by the customer. As of January 31, 2009 and April 30, 2008, our funded backlog was approximately \$139.0 million and \$82.0 million, respectively. Funded backlog as of January 31, 2009 includes a \$39.0 million order for Raven systems that was executed on January 30, 2009 with a stated effective date of February 1, 2009.

In addition to our funded backlog, we also had unfunded backlog of \$513.1 million and \$384.3 million as of January 31, 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. Unfunded backlog does not include the value of options to purchase additional aircraft included in our Global Observer contract. 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

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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.

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. 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.

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Recent global market and economic conditions have been unprecedented and challenging with tighter credit conditions and recession in most major economies continuing into 2009. 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 business and consumers. These factors have led to a decrease in spending by businesses and consumers alike, and a corresponding decrease in global infrastructure spending. Continued turbulence in the U.S. and international markets and economies and prolonged declines in business and consumer spending may adversely affect our liquidity and financial condition, and the liquidity and financial condition of our customers, including our ability to access the capital markets to meet liquidity needs. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits. Given the current instability of financial institutions, we cannot be assured that we will not experience losses on these deposits.

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

## Cash Flows

The following table provides our cash flow data for the nine months ended January 31, 2009 and January 26, 2008 (in thousands):

|   | Nine Months Ended   |                     |
|---|---------------------|---------------------|
|   | January 31,<br>2009 | January 26,<br>2008 |
|   | (Unaudited)         |                     |
| Net cash provided by operating activities           | \$ 20,980           | \$ 6,827            |
| Net cash (used in) provided by investing activities | \$ (25,085)         | \$ 50,906           |
| Net cash provided by financing activities           | \$ 979              | \$ 912              |

**Cash Provided by Operating Activities.** Net cash provided by operating activities for the nine months ended January 31, 2009 increased by \$14.2 million to \$21.0 million, compared to net cash provided by operating activities of \$6.8 million for the nine months ended January 26, 2008. This increase in net cash provided by operating activities was primarily due to lower working capital needs of \$8.9 million, higher income of \$3.4 million, and higher depreciation of \$1.0 million.

**Cash Used in Investing Activities.** Net cash used in investing activities increased by \$76.0 million to \$25.1 million for the nine months ended January 31, 2009, compared to net cash provided by investing activities of \$50.9 million for the nine months ended January 26, 2008. The increase in net cash used in investing activities was primarily due to increase in net purchases of investments of \$73.7 million and higher capital expenditures of \$2.3 million.

**Cash Provided by Financing Activities.** Net cash provided by financing activities increased by \$0.1 million to \$1.0 million



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for the nine months ended January 31, 2009, compared to \$0.9 million for the nine months ended January 26, 2008. During the nine months ended January 31, 2009, we received proceeds from stock option exercises of \$1.0 million.

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

During the third quarter, there were no material changes in our off balance sheet arrangements or contractual obligations and commercial commitments from those disclosed in the Form 10-K for the fiscal year ended April 30, 2008.

### **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**

See Note 1 to our unaudited consolidated financial statements included elsewhere in this quarterly report for disclosure on new accounting pronouncements.

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

In the ordinary course of business, we are exposed to various market risk factors, including fluctuations in interest rates, changes in general economic conditions, domestic and foreign competition, and foreign currency exchange rates. Please refer to Item 7A Quantitative and Qualitative Disclosures About Market Risk, contained in our Annual Report on Form 10-K for the fiscal year ended April 30, 2008, for further discussion on quantitative and qualitative disclosures about market risk.

***Interest Rate Risk***

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

***Foreign Currency Exchange Rate Risk***

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

**ITEM 4. CONTROLS AND PROCEDURES**

***Controls and Procedures***

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

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

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

disclosure controls and procedures.

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

***Internal Control over Financial Reporting***

There were no changes in our internal control over financial reporting or in other factors identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the quarter ended January 31, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors disclosed under Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the fiscal year ended April 30, 2008, and our quarterly reports on Form 10-Q for the three month periods ended August 2, 2008 and November 1, 2008, other than with respect to the risk factor set forth below in this Item 1A entitled 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, which has been revised to reflect our current holdings of auction rate securities. Please refer to that section of our Annual Report on Form 10-K for disclosures regarding the risks and uncertainties related to our business.

*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 January 31, 2009, our \$7.1 million of long-term investments, recorded at fair value, consisted entirely of auction rate municipal bonds with maturities that range from approximately 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, 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 February 25, 2009, including the securities involved in failed auctions, we held approximately \$7.1 million of these auction rate securities, all of which carry investment grade ratings. 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 26 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.



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

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

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

None.

**ITEM 5. OTHER INFORMATION**

None.

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**ITEM 6. EXHIBITS**

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

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**SIGNATURES**

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

Date: March 10, 2009

AEROVIRONMENT, INC.

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

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