AeroVironment Inc
Form 10-K
June 27, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended April 30, 2018
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.)
800 Royal Oaks Drive, Suite 210	
Monrovia, CA	91016
(Address of Principal Executive Offices)	(Zip Code)

Registrant’s telephone number, including area code: (626) 357 9983

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

Title of Class	Name of each exchange on which registered

Common Stock, par value $0.0001 per share	The NASDAQ Stock Market LLC

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

None

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

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

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

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

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

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

Large accelerated filer Accelerated filer Smaller reporting company

Non-accelerated filer (Do not check if a smaller reporting company) Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the voting stock held by non affiliates of the registrant, based on the closing price on the NASDAQ Global Select Market on October 28, 2017 was approximately $1,074.2 million.

As of June 20, 2018, the issuer had 23,906,534 shares of common stock, par value $0.0001 per share, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the conclusion of the registrant's fiscal year ended April 30, 2018, are incorporated by reference into Part III of this Form 10 K.

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AEROVIRONMENT, INC.

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PART I

Forward Looking Statements

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

· our ability to consummate the sale of the assets of our Efficient Energy Systems (“EES”) business segment to Webasto Charging Systems, Inc., as described in this Annual Report;

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

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

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

· our ability to remain a market innovator and to create new market opportunities;

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

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

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

· increased competition, including from firms that have substantially greater resources than we have and in the UAS business from lower cost consumer drone manufacturers who may seek to enhance their systems’ capabilities over time;

- the complexities and uncertainty of obtaining and conducting international business, including export compliance and other reporting requirements;

- the impact of potential security and cyber threats;

- uncertainty in the customer adoption rate of commercial use unmanned aircraft systems;

- changes in the regulatory environment; and

- general economic and business conditions in the United States and elsewhere in the world.

Set forth below in Item 1A, “Risk Factors” are additional significant uncertainties and other factors affecting forward looking statements. The reader should understand that the uncertainties and other factors identified in this Annual Report are not a comprehensive list of all the uncertainties and other factors that may affect forward looking

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statements. We do not undertake any obligation to update or revise any forward looking statements or the list of uncertainties and other factors that could affect those statements.

Item 1. Business.

Proposed Sale of EES Business Segment

On June 1, 2018, we entered into an Asset Purchase Agreement (the "Purchase Agreement") with Webasto Charging Systems, Inc. ("Webasto") pursuant to which we agreed to sell, and Webasto agreed to acquire, substantially all of the assets of our Efficient Energy Systems business segment (the "EES Business") and to assume certain liabilities related to the EES Business. The closing of the transactions contemplated by the Purchase Agreement is subject to certain closing conditions, including: (i) the accuracy of each party's representations and warranties (subject to customary materiality qualifiers), (ii) each party's compliance with its covenants and agreements contained in the Purchase Agreement (subject to customary materiality qualifiers), (iii) the execution by the parties of certain ancillary agreements and (iv) other customary closing conditions. As of April 30, 2018, we determined that the EES Business met the criterion for classification as an asset held for sale and represents a strategic shift in in our operations. Therefore, the assets and liabilities and the results of operations of the EES Business are reported in this Annual Report as discontinued operations for all periods presented.

The disclosures and references in this Annual Report, including financial data, the description of our business operations in this Item 1, and risk factors related to our operations included in Item 1A relate to our continuing operations, unless otherwise specifically noted.

Overview

We design, develop, produce, support and operate a technologically advanced portfolio of products and services for government agencies and businesses. We supply unmanned aircraft systems ("UAS") and related services primarily to organizations within the U.S. Department of Defense ("DoD") and to international allied governments, and tactical missile systems and related services to organizations within the U.S. Government. We derive the majority of our revenue from these business areas and we believe that the markets for these solutions have significant growth potential. Additionally, we believe that some of the innovative potential products and services in our research and development pipeline will emerge as new growth platforms in the future, creating additional market opportunities.

Our success with current products and services stems from our investment in research and development and our ability to invent and deliver advanced solutions, utilizing proprietary and commercially available technologies, to help our government, commercial and consumer customers operate more effectively and efficiently. We develop these highly innovative solutions by working very closely with our key customers to solve their most important challenges related to our areas of expertise. Our core technological capabilities, developed through more than 45 years of innovation, include lightweight aerostructures; power electronics; electric propulsion systems; efficient electric power conversion, and storage systems; high density energy packaging; miniaturization; digital data links (“DDL”); sensors; controls integration; systems integration; engineering optimization; vertical takeoff fixed wing flight and autonomy, each coupled with professional field service capabilities.

Our UAS business focuses primarily on the design, development, production, marketing, support and operation of innovative UAS and tactical missile systems and the delivery of UAS related services that provide situational awareness, remote sensing, multi band communications, force protection and other information and mission effects to increase the safety and effectiveness of our customers’ operations.

Our Strategy

As a technology solutions provider, our strategy is to develop innovative, safe and reliable new solutions that provide customers with valuable benefits and enable us to create new markets or market segments, gain market share and grow as market adoption increases. We believe that by introducing new solutions that provide customers with compelling value we are able to create new markets or market segments and then grow our positions within those

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markets or market segments profitably, instead of entering existing markets and competing directly against large, incumbent competitors that may possess advantages in scope, scale, resources and relationships.

We intend to grow our business by preserving a leadership position in the UAS and tactical missile system markets, and by creating new solutions that enable us to create and establish leadership positions in new markets. Key components of this strategy include the following:

Expand our market leadership to grow existing markets and create new adjacent markets. Our small UAS and tactical missile systems enjoy leading positions in their respective markets. We intend to increase the penetration of our small UAS products and services within the U.S. military, the military forces of allied nations, other government agencies and non government organizations, including commercial entities, and to increase the penetration of our tactical missile systems within the U.S. military and allied nations. We believe that the broad adoption of our small UAS by the U.S. military will continue to spur demand by allied nations, and that our efforts to pursue new applications are creating opportunities beyond the early adopter military market.

Deliver innovative new solutions for existing and new markets. Customer focused innovation is the primary driver of our growth. We plan to continue pursuing internal and customer funded research and development to develop better, more capable products, services and business models, both in response to and in anticipation of emerging customer needs. In some cases, these innovations result in upgrades to existing offerings, expanding their value among existing customers and markets. In other cases, these innovations become entirely new solutions that position us to address new markets, customers and business opportunities. We believe focused research and development investments will allow us to deliver innovative new products and services that address market needs within and outside of our current target markets, and enable us to create new opportunities for growth. We view strategic partnerships as a means by which to further the reach of our innovative solutions through access to new markets, customers and complementary capabilities.

Foster our entrepreneurial culture and continue to attract, develop and retain highly skilled personnel. Our company culture encourages innovation and an entrepreneurial spirit, which helps to attract and retain highly skilled professionals. We intend to preserve this culture to encourage the development of the innovative, highly technical system solutions and business models that give us our competitive advantage. A core component of our culture is our intent to demonstrate trust and integrity in all of our interactions, contributing to a positive work environment and engendering loyalty among our employees and customers.

Preserve our agility and flexibility. We respond rapidly to evolving markets, solve complicated customer problems, and strive to deliver new products, services and capabilities quickly, efficiently and affordably relative to available alternatives. We believe our agility and flexibility help us to strengthen our relationships with customers and partners. We intend to maintain our agility and flexibility, which we believe to be important sources of differentiation when we compete against organizations with more extensive resources.

Effectively manage our growth portfolio for long term value creation. Our production and development programs and services position us for investment opportunities that we believe will deliver long term growth by providing our customers with valuable new capabilities. We evaluate each opportunity independently and within the context of other investment opportunities to determine its relative timing and potential, and thereby its priority. This process helps us to make informed decisions regarding potential growth capital requirements and supports how we allocate resources based on relative risks and returns to maximize long term value creation, which is a key element of our growth strategy. We also review our portfolio on a regular basis to determine if and when to narrow our focus on the highest potential growth opportunities.

Customers

We sell the majority of our UAS and services to organizations within the DoD, including the U.S. Army, Marine Corps, Special Operations Command, Air Force and Navy, and increasingly to allied governments. We sell our tactical missile systems to organizations within the U.S. government. We also develop High Altitude Pseudo-Satellite ("HAPS") systems for a commercial customer based in Japan.

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During our fiscal year ended April 30, 2018, we generated approximately 19% of our revenue from the U.S. Army pursuant to orders placed under contract by the U.S. Army on behalf of itself as well as several other organizations within the DoD. Other U.S. government agencies and government subcontractors accounted for 35% of our sales revenue, while purchases by foreign, commercial and consumer customers accounted for the remaining 46% of sales revenue during our fiscal year ended April 30, 2018.

Technology, Research and Development

Technological Competence and Intellectual Property

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

The innovations developed by our company and our founder include, among others: the world's first effective human powered and manned solar powered airplanes; the first modern passenger electric car, the EV1 prototype for General Motors; the world's highest flying airplane in level flight, Helios™, a solar powered unmanned aircraft system that reached over 96,000 feet above sea level in 2001; Global Observer, the world's first liquid hydrogen fueled unmanned aircraft system; the Nano Hummingbird™, the world's first flapping wing unmanned aircraft system capable of precise hover and omni directional flight; and Blackwing™, the first submarine-launched unmanned aircraft system deployed by the U.S. Navy. The Smithsonian Institution possesses seven vehicles developed by our company or our founder in its permanent collection. Our history of innovation excellence is the result of our talented, creative and skilled employees whom we encourage to invent and develop innovative new solutions.

A component of our ongoing innovation is a screening process that helps our business managers identify early market needs, which assists us in making timely investments into critical technologies necessary to develop solutions to address these needs. Similarly, we manage new product and business concepts through a commercialization process that balances spending, resources, time and intellectual property considerations against market requirements and potential returns on investment. Strongly linking our technology and business development activities to customer needs in attractive growth markets constitutes an important element of this process. Through the process we revisit our customer requirement assumptions to evaluate continued investment and to help ensure that our products and services deliver high value.

As a result of our commitment to research and development, we possess an extensive portfolio of intellectual property in the form of patents, trade secrets, copyrights and trademarks across a broad range of UAS and advanced energy technologies. As of April 30, 2018, we had 201 U.S. patents issued; 87 U.S. patent applications pending; 7 active

Patent Cooperation Treaty applications; and numerous foreign patents and applications, of which 51 U.S. patents, 20 U.S. patent applications and no active Patent Cooperation Treaty applications are anticipated to be assigned to Webasto upon the closing of the transactions contemplated by the Purchase Agreement. In many cases, when appropriate and to preserve confidentiality, we opt to protect our intellectual property through trade secrets as opposed to filing for patent protection. Pursuant to the Purchase Agreement, a portion of our patents and pending patent applications relating to the EES Business will be sold and to Webasto at the closing of the transactions contemplated by the Purchase Agreement.

The U.S. government has licenses to some of our intellectual property that was specifically developed in performance of government contracts, and may use or authorize others to use this intellectual property. In some cases we fund the development of certain intellectual property to maximize its value and limit its use by potential competitors. While we consider the development and protection of our intellectual property to be integral to the future success of our business, at this time we do not believe that a loss or limitation of rights to any particular piece of our intellectual property would have a material adverse effect on our overall business.

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Research, Development and Commercialization Projects

A core component of our business strategy is the focused development and commercialization of innovative solutions that we believe can become new products or services that enable us to create large new markets or accelerate the growth of our current products and services. We invest in an active pipeline of these commercialization projects that range in maturity from technology validation to early market adoption. We cannot predict when, if ever, we will successfully commercialize these projects, or the exact level of capital expenditures they could require, which could be substantial.

For the fiscal years ended April 30, 2018, 2017 and 2016, our internal research and development spending amounted to 10%, 12% and 15%, of our revenue, respectively, and customer funded research and development spending amounted to an additional 19%, 19% and 23%, of our revenue, respectively.

Sales and Marketing

Our marketing strategy is based on developing leadership positions in new markets that we create through the introduction of innovation solutions that improve customer operational effectiveness and efficiency. Our ability to operate in an agile, flexible manner helps us achieve first mover advantage and work closely with early customers to achieve the successful adoption of our solutions. Once we establish a market position we work to maintain our leadership position while seeking to grow our revenue by expanding sales and through continuous innovation and customer support. Our reputation for innovation is a key component of our brand and has been acknowledged through a variety of awards and recognized in numerous articles in domestic and international publications. We have U.S. registered trademarks for AeroVironment, AV, Switchblade, Raven, Wasp, Snipe, and EV Solutions, and have several other pending applications for trademark registration. Pursuant to the Purchase Agreement, a portion of our registered trademarks and pending trademark registration applications that relate to the EES Business will be sold and assigned to Webasto at the closing of the transactions contemplated by the Purchase Agreement, including the U.S. registered trademarks for EV Solutions, TurboCord, PosiCharge, BMID, BATTERY RX, Procore, Powered Your Way, Turbodock, NXT, and Turbo DX.

International Sales

We contract with international sales representatives and team with domestic organizations in a number of foreign markets and believe that these markets represent growth opportunities for our business. Our international sales accounted for approximately 46%, 37% and 29%, of our revenue for the fiscal years ended April 30, 2018, 2017 and 2016, respectively.

Competition

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

Manufacturing and Operations

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

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We outsource certain production activities, such as the fabrication of structures, the manufacture of electronic printed circuit board subassemblies, payload components and, the production of our Quantix drone, to qualified suppliers, with many of whom we have long term relationships. This outsourcing enables us to focus on final assembly, system integration and test processes for our products, ensuring high levels of quality and reliability. We forge strong relationships with key suppliers based on their ability to grow with our production needs and support our growth plans. We continue to expand upon our suppliers' expertise to improve our existing products and develop new solutions. We rely on both single and multiple suppliers for certain components and subassemblies. See "Risk Factors—If critical components or raw materials used to manufacture our products become scarce or unavailable, then we may incur delays in manufacturing and delivery of our products, which could damage our business" for more information. All of our production system operations incorporate internal and external quality programs and processes to increase acceptance rates, reduce lead times and lower cost.

Customer Funded Research and Development

We actively pursue externally funded projects that help us to strengthen our technological capabilities. Our UAS business submits bids to large research customers such as the Defense Advanced Research Projects Agency, the U.S. Air Force, the U.S. Army and the U.S. Special Operations Command for projects that we believe have future commercial application. In some cases commercial enterprises may fund our research and development activities, as with our HAPSMobile, Inc. development program. Providing these services contributes to the development and enhancement of our technical competencies. In an effort to manage the ability of our key technical personnel to support multiple, high value research and development initiatives, we attempt to limit the volume of customer funded research and development projects that we accept. This process enables us to focus these personnel on projects we believe offer the greatest current and future value to our business.

Seasonality

Historically, and more pronounced in recent years, our revenue in the second half of our fiscal years has exceeded our revenue in the first half of our fiscal years. The factors that affect our revenue recognition between accounting periods include the timing of new contract awards, the availability of U.S. government and international government funding, lead time to manufacture our family of systems to customer specification, customer acceptance and other regulatory requirements. We expect our fiscal year 2019 to have more balanced revenue between the first and second halves.

Raw Materials and Suppliers

Historically, we have not experienced significant delays in the supply or availability of our key raw materials or components provided by our suppliers, nor have we experienced a significant price increase for raw materials or components. We do not anticipate any such delays or significant price increases in our fiscal year 2019.

Contract Mix

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

	Fiscal Year Ended April 30,		
	2018	2017	2016
Fixed-price contracts	80 %	76 %	75 %
Cost-reimbursable contracts	20 %	24 %	25 %

Employees

As of April 30, 2018, we had 697 full time employees of our continuing business operations, of whom 253 were in research and development and engineering, 34 were in sales and marketing, 252 were in operations and 158 were general and administrative personnel. We believe that we have a good relationship with our employees. As of April 30,

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2018, we had 100 employees of our EES Business. Upon the closing of the transactions contemplated by the Purchase Agreement, it is anticipated that we will terminate the employees of the EES Business who will become employees of Webasto after the closing.

Backlog

We define funded backlog as unfilled firm orders for products and services for which funding currently is appropriated to us under the contract by the customer. As of April 30, 2018 and 2017, our funded backlog was approximately $174.3 million and $70.9 million, respectively. We expect that approximately 84% of our funded backlog will be filled during our fiscal year ending April 30, 2019.

In addition to our funded backlog, we had unfunded backlog of $58.1 million and $14.1 million as of April 30, 2018 and 2017, respectively. We define unfunded backlog as the total remaining potential order amounts under cost reimbursable and fixed price contracts with (i) multiple one year options, and indefinite delivery, indefinite quantity, or IDIQ contracts, or (ii) incremental funding. Unfunded backlog does not obligate the customer 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. Unfunded backlog does not include the remaining potential value associated with a U.S. Army IDIQ type contract for small UAS because that contract was awarded to seven companies in 2018, including AeroVironment, and we cannot be certain that we will receive all task orders issued against the contract.

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, are renewed, or new contracts are awarded. A majority of our contracts, specifically our IDIQ contracts, do not obligate the U.S. government to purchase any goods or services. Additionally, all U.S. government contracts included in backlog, whether or not they are funded, may be terminated at the convenience of the U.S. government.

Other Information

AeroVironment, Inc. was originally incorporated in the State of California in July 1971 and reincorporated in Delaware in 2006.

Our principal executive offices are located at 800 Royal Oaks Drive, Suite 210, Monrovia, California 91016. Our telephone number is (626) 357 9983. Our website home page is http://www.avinc.com. We make our website content available for information purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference into this Annual Report.

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

Unmanned Aircraft Systems

Our UAS business addresses the increasing economic and security value of network centric intelligence, surveillance and reconnaissance (“ISR”) communications, remote sensing and effects delivery with innovative UAS and tactical missile system solutions.

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Industry Background

Small UAS

The defense market for small UAS has grown significantly since the early 2000s driven largely by the demands associated with the global threat environment and the resulting procurement by military customers, the early adopters for this technology. Small UAS now represent an accepted and enduring capability for the military. The U.S. military's transformation into a smaller, more agile force that operates via a network of observation, communication and precision targeting technologies accelerated following the terrorist attacks of September 11, 2001, as it required improved, distributed observation and targeting of enemy combatants who operate in small groups, often embedded in dense population centers or dispersed in remote locations. We believe that UAS, which range from large systems, such as Northrop Grumman's Global Hawk and General Atomics' Predator, Sky Warrior, Reaper and Gray Eagle, to small systems, such as our Raven, Wasp AE, Puma AE and Snipe, serve as integral components of today's military force. These systems provide critical observation and communications capabilities serving the increasing demand for actionable intelligence, while reducing risk to individual "warfighters." Small UAS can provide real time observation and communication capabilities to the small units who control them. As airspace regulations in the U.S. and other nations evolve to accommodate the commercial use of small UAS, we are furthering the application of small UAS technology in new markets such as precision agriculture. We expect further growth through the introduction of UAS technology and services to these emerging commercial applications.

Tactical Missile Systems

The development of weapons capable of rapid deployment and precision strike while minimizing the risk to surrounding civilians, property and operators accelerated in recent years due to advances in enabling technologies. Weapons such as laser guided missiles, "smart" bombs and GPS guided artillery shells have dramatically improved the accuracy of strikes against hostile targets. When ground forces find themselves engaged in a firefight or near a target, their ability to employ a precision weapon system quickly and easily can mean the difference between mission success and failure. A rapidly deployable solution could address emerging requirements beyond ground engagements for use in other types of situations and from a variety of sea, air and land platforms. We believe that embedding a precision lethal payload into a remotely controlled, man portable delivery system provides warfighters with a valuable and more cost effective alternative to existing munition and missile systems.

Large UAS

We believe a market opportunity exists for large UAS that can fly for long periods of time to provide continuous remote sensing and communications in an affordable manner over great distances. Existing solutions such as communications satellites and manned and unmanned aircraft address some of the emerging demand for this capability, but do so at relatively high financial and resource costs. Geosynchronous satellites provide fixed, continuous communications capabilities to large portions of the globe, but they operate more than 20,000 miles from the surface of the earth, therefore limiting the bandwidth they can provide and requiring relatively larger, higher power ground stations. Remote sensing satellites typically operate at lower altitudes, but are unable to maintain geosynchronous positions, meaning they are moving with respect to the surface of the earth, resulting in a limited presence over specific areas of interest and significant periods of time during which they are not present over those areas. A new category of constellations consisting of a large number of very small and low earth orbiting satellites is designed to provide a lower cost alternative with more ubiquitous coverage for reconnaissance and communication, but has yet to be deployed in meaningful quantities. UAS that are capable of operating in an affordable manner for extended periods of time over an area of interest without gaps in availability while carrying a communications or observation payload could help to satisfy this need.

Our UAS Solutions

We supply our UAS products and services to multiple customers within and outside of the United States.

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Small UAS Products

Our small UAS, including Raven, Wasp AE, Puma AE and Snipe, are designed to operate reliably a few hundred feet above the ground in a wide range of environmental conditions, providing a vantage point from which to collect and deliver valuable information. Military forces employ our small UAS to deliver ISR and communications, including real time tactical reconnaissance, tracking, combat assessment and geographic data, directly to the small tactical unit or individual operator, thereby increasing flexibility in mission planning and execution. In commercial applications, we operate our small UAS as part of a turnkey information solution to deliver advanced analysis that can reduce customers' costs, enhance their safety and increase their revenue. Our small UAS wirelessly transmit critical live video and other information generated by their payload of electro optical, infrared or other sensors directly to a hand held ground control unit, enabling the operator to view and capture images, during the day or at night, on the control unit. Our Quantix data collection drone generates a volume of high-resolution data significantly larger than wireless bandwidth can accommodate, requiring the transfer of data once the air vehicle has landed. With the exception of Quantix, our ground control systems allow the operator to control the aircraft by programming it for GPS based autonomous navigation using operator designated way points, or by manual flight operation. The ground control systems are designed for durability and ease of use in harsh environments and incorporate a user friendly, intuitive user interface. All of our fixed wing small UAS currently in production for military customers operate from our common ground control system.

We designed our small UAS to be transportable by a single person, assembled without tools in less than five minutes and launched and operated by one or two people, with limited training required. The efficient and reliable electric motors used in all of our small UAS are powered by modular battery packs that can be replaced quickly, enabling rapid return to flight. We designed all of our small UAS to be reusable for hundreds of flights under normal operating circumstances and to be recovered through an autonomous landing feature that enables a controlled descent to a designated location.

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

In emerging commercial applications, our small UAS enable enterprises to manage valuable assets such as crops, powerlines and railroad infrastructure, more effectively and safely than previously possible. Our Quantix data collection drone and AeroVironment Decision Support System ("AVDSS"), a cloud based platform for processing, analyzing and storing collected data, are designed to provide agriculture operations with more accurate and timely information regarding their crops. Better and more timely information can translate into more efficient activities that facilitate more efficient use of scarce resources such as water for agriculture.

Our small UAS offering also includes spare equipment, alternative payload modules, batteries, chargers, repair services and customer support. We provide training by our highly skilled instructors, who typically possess extensive military experience, and continuous refurbishment and repair services for our products. We designed our Quantix system for minimal training so customers can learn how to operate it on their own. By maintaining close contact with our customers and users in the field, we gather critical feedback on our products and incorporate that information into ongoing product development and research and development efforts. This approach enables us to improve our solutions in response to, and in anticipation of, evolving customer needs.

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

Small UAS Product	Wingspan (ft.)	Weight (lbs.)	Recovery	Standard Sensors	Range (mi.)(1)	Flight Time (min.)(1)
Puma AE	9.2	14	Vertical autonomous landing capable (ground or water)	Mechanical pan, tilt, zoom and digital zoom electro-optical and infrared	9.0	210
Raven	4.5	4.5	Vertical autonomous landing capable	Mechanical pan, tilt, zoom and digital zoom electro-optical and infrared	6.0	60 - 90
Wasp AE	3.3	2.8	Vertical autonomous landing capable (ground or water)	Mechanical pan, tilt, zoom and digital zoom electro-optical and infrared	3.0	50
Snipe	0.8	0.3	Vertical takeoff and landing	Mechanical tilt, electro-optical and infrared	0.6	15

(1) Represents point to point minimum customer mandated specifications for all operating conditions. In optimal conditions, the performance of our products may significantly exceed these specifications. Our DDL relay can enable operational modes that can extend range significantly.

The ground control system serves as the primary interface between the operator and our small UAS designed for defense applications, and allows the operator to control the direction, speed and altitude of the aircraft as well as the orientation of the sensors to view the visual information they produce through real time, streaming video and metadata. Our common ground control system interfaces with each of our air vehicles, except Snipe, providing a common user interface with each of our air vehicles. In addition to the thousands of air vehicles delivered to our customers, thousands of ground control systems are also in our customers' hands.

The Snipe nano quadrotor is an unmanned aircraft system tailored to the needs of frontline troops who need immediate situational awareness. Snipe incorporates an advanced touch screen interface to control the system and view the information produced by the air vehicle's onboard sensors. Highly portable and easy to assemble, operate and stow, Snipe is designed to provide rapid airborne information within one kilometer of its launch point in situations where time is short and risk is high.

Our line of miniature gimbaled sensor payloads provides small UAS operators with enhanced observation and target tracking functionality. Our DDL is integrated into Puma AE, Raven and Wasp AE and Snipe systems, enhancing their capabilities, and ultimately, the utility of our small UAS by enabling more efficient radio spectrum utilization and communications security. Small UAS incorporating our DDL offer many more channels as compared to our analog link, increasing the number of air vehicles that can operate in a given area. Additionally, our DDL enables each air vehicle to operate as an Internet Protocol addressable hub capable of routing and relaying video, voice and data to and from multiple other nodes on this ad hoc network. This capability enables beyond line of sight operation of our small UAS, further enhancing their value proposition to our customers.

Tactical Missile Systems Products

Our tactical missile systems consist of tube-launched aircraft that deploy with the push of a button, fly at higher speeds than our small UAS, and perform either effects delivery or reconnaissance missions. Switchblade, the first of our tactical missile systems products, can be transported in its launch tube, within a backpack, and deployed within minutes to defend against lethal threats such as snipers and mortar teams. With a high level of precision, including a custom warhead, wave-off, loiter and re-engagement capabilities, Switchblade can neutralize a target rapidly and accurately without causing collateral damage. Furthermore, because it streams live electro-optical and thermal video to its operator, Switchblade can be called off in the final moments prior to a strike should the situation require, minimizing damage to non-combatants. Blackwing, a variant of Switchblade, launches from a submerged submarine and carries extra batteries instead of a warhead, providing longer flight time for reconnaissance operations.

UAS Logistics Services

In support of our small UAS for defense applications we offer a suite of services that help to ensure the successful operation of our products by our customers. These services generate incremental revenue for us and provide us with continuous feedback to understand the performance of our systems, anticipate our customers' needs and develop

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additional customer insights. We believe that this ongoing feedback loop enables us to continue to provide our customers with innovative solutions that help them succeed. We provide spare parts as well as repair, refurbishment and replacement services in a manner that seeks to minimize supply chain delays, and we support our customers with spare parts, replacement aircraft and support whenever and wherever they need them. One of our facilities also serves as the primary depot for repairs and spare parts.

We provide comprehensive training services to support all of our small UAS for defense applications. Our highly skilled instructors typically have extensive military experience. We deploy training teams throughout the continental United States and overseas to support our customers' training needs on both production and development stage systems.

UAS Customer Funded Research and Development

We provide specialized services in support of customer funded research and development projects, delivering new value added technology solutions to our customers. These types of projects typically involve developing new system solutions and technology or new capabilities for existing solutions that we introduce as retrofits or upgrades. We recognize customer funded research and development projects as revenue.

UAS Technology, Research and Development

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

· lightweight, low speed aerostructures and aerodynamic design;

· miniaturized avionics and micro/nano unmanned aircraft systems;

· image stabilization and target tracking;

· software;

·

sensor design, development, miniaturization and integration;

· advanced flight control systems;

· electric propulsion systems;

· high altitude long endurance flight operations;

· fluid dynamics;

· miniature, low power wireless digital communications;

· vertical takeoff and landing fixed wing flight unmanned aircraft systems; and

· system integration and optimization.

Three of our UAS and tactical missile systems development initiatives are described below:

Tactical Missile System Variants. We pioneered our first rapidly deployable, high precision tactical missile system, named Switchblade, for use by defense ground forces. Switchblade is now deployed by the U.S. military to provide force protection to its troops overseas in combat operations.

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During a multitude of demonstrations over the course of several years, multiple potential customers requested modifications to Switchblade to accommodate their specific mission requirements. We performed a number of successful demonstrations and are now developing several variants to Switchblade for new customers and applications, including deployment from sea and air vehicles. Blackwing, a submarine-launched reconnaissance system, represents one of the variants. Other variants have transitioned into production and sale to U.S. customers. We believe these new variants have the potential to expand our tactical missile systems opportunities significantly.

Commercial Unmanned Aircraft Systems Based Information Solutions. In the same way our small UAS provide situational awareness to military customers, we can employ our small UAS with advanced sensors to scan vast or inaccessible infrastructure, plants or wildlife, then process and analyze the resulting data to produce actionable information for a wide variety of companies in industries that include energy, agriculture and natural resource management. Our Quantix data collection drone is designed for highly automated vegetation and topographical scanning of more than 400 acres in its 45 minute flight time. Equipped with fixed electro-optical and multi-spectral sensors, Quantix takes off vertically, transitions to horizontal operation, flies its designated mission, then lands itself vertically at its launch point. Lower resolution data can be viewed immediately through the wireless transmission of image data from the Quantix to its commercial tablet controller pre-loaded with custom software. Further automated analysis can be performed by uploading the data to the AVDSS, a cloud-based platform for processing, analyzing and storing collected data. We have developed this capability based on extensive work with early adopters for anticipated adoption in what could be a large market.

High Altitude Pseudo-Satellites, or HAPS. Building on our decades of groundbreaking development and demonstration of high altitude solar-powered UAS, in 2018 we established a joint venture with SoftBank Corp. to create a global broadband and telecommunications company to demonstrate and deploy HAPS UAS around the world. HAPSMobile, Inc. is five percent owned by AeroVironment, Inc. and 95 percent owned by SoftBank Corp. The joint venture is providing $76 million in funding to AeroVironment to develop and demonstrate solar HAPS UAS. AeroVironment possesses exclusive rights to manufacture and supply the solar HAPS UAS developed by the joint venture to HAPSMobile, Inc., subject to meeting contractual performance criteria. HAPSMobile, Inc. possesses exclusive rights to the solar HAPS UAS for commercial markets globally, while AeroVironment possesses exclusive rights to the solar HAPS UAS for non-commercial markets globally, with the exception of Japan.

UAS Sales and Marketing

We organize our U.S. UAS business development team members by target market and customer and we locate team members in close proximity to the customers they support, where possible. We organize our program managers by product and focus on designing optimal solutions and contract fulfillment, as well as internalizing feedback from customers and users. By maintaining assigned points of contact with our customers, we believe that we are able to maintain our relationships, service existing contracts effectively and gain vital feedback to improve our responsiveness and product offerings. We employ a direct-sale and dealer-based distribution strategy for our Commercial Information Solutions.

UAS Manufacturing and Operations

Continued investment in infrastructure has established our manufacturing capability to meet demand with scalable capacity. We have the manufacturing infrastructure to produce UAS products at rates higher than our historical volumes, support initial low rate production for new UAS development programs and tactical missile systems and execute initial low rate production of large UAS. By drawing upon experienced personnel across various manufacturing industries including aerospace, automotive and volume commodities, we have instituted lean production systems and leverage our International Organization for Standardization, or ISO certification for Quality Management, integrated supply chain strategy, document control systems and process control methodologies for production. Presently, we

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perform small UAS manufacturing at the 85,000 square foot manufacturing facility we established in 2005. Our 9001:2015 + AS9100D certified manufacturing facilities are designed to accommodate demand of up to 1,000 aircraft per month. ISO 9001:2015 + AS9100D refers to a set of voluntary standards for quality management systems. These standards are established by the ISO to govern quality management systems used worldwide. Companies that receive ISO certification have passed audits performed by a Registrar Accreditation Board certified auditing company. These audits evaluate the effectiveness of companies' quality management systems and their compliance with ISO standards. Some companies and government agencies view ISO certification as a positive factor in supplier assessments.

UAS Competition

The market for defense small UAS continues to evolve in response to changing technologies, shifting customer needs and expectations and the potential introduction of new products. We believe that a number of established domestic and international defense contractors have developed or are developing small UAS that continue to compete, or will compete, directly with our products. Some of these contractors have significantly greater financial and other resources than we possess. Our current principal small UAS competitors include Elbit Systems Ltd., L3 Technologies, Inc., and Lockheed Martin Corporation. We do not view large UAS such as Northrop Grumman Corporation's Global Hawk, General Atomics, Inc.'s Predator and its derivatives, The Boeing Company's ScanEagle and Textron Inc.'s Shadow as direct competitors to our small UAS because they perform different missions, do not typically deliver their information directly to front line ground forces and are not hand launched and controlled. However, we cannot be certain that these platforms will not become direct competitors in the future. Potential competition from consumer-focused drone manufacturers could emerge as their capabilities increase and their prices remain low relative to existing defense solutions, which could result in some level of military consideration even if such drones do not meet traditional military performance or security specifications.

The market for HAPS UAS is in an early stage of development. As a result, this category is not well defined and is characterized by multiple potential solutions. An existing contractor that claims to provide high altitude long endurance UAS is Northrop Grumman Corporation with its Global Hawk. Several aerospace and defense contractors are pursuing this market opportunity with proposed very long duration UAS, including The Boeing Company, Airbus, Lockheed Martin Corporation and Northrop Grumman Corporation. Some internet technology companies have acquired small firms that focus on this type of capability and represent potential future competitors. Companies pursuing airships (high altitude aircraft that are kept buoyant by a body of gas that is lighter than air) as a solution for this market include Lockheed Martin Corporation and Northrop Grumman Corporation. Companies pursuing conventional satellites as a solution for this market include The Boeing Company, Lockheed Martin Corporation, General Dynamics Corporation, EADS N.V., Ball Corporation and Orbital Sciences Corporation. Companies pursuing Low Earth Orbit, or LEO, micro or cubesat satellite constellations for global communication and remote sensing include OneWeb, SpaceX and The Boeing Company.

The market for tactical missile systems is in an early stage of development, but it is evolving rapidly. Competitors in this market include Textron Inc., Raytheon Company and Lockheed Martin Corporation.

The market for commercial UAS products and services is in an early stage of development, but is evolving rapidly, generating a great deal of interest as government regulations evolve to accommodate commercial UAS operations in the National Airspace System and in the airspace systems of other countries. Given the breadth of applications and the diversity of industries that could benefit from UAS technology, a growing number of potential competitors in this market include consumer drone manufacturers such as Dà-Jiāng Innovation, who seek to enhance their systems' capabilities over time; other small UAS manufacturers, including large aerospace companies such as Lockheed Martin Corporation, and drone and aerial surveying and mapping service providers such as PrecisionHawk and AgEagle; ground based surveying and mapping service providers; satellite imagery providers; and specialty system manufacturers, software as a service and other service providers aiming to address specific market segments. The emerging non military market is attracting numerous additional competitors and significant venture capital funding given perceived lower barriers to entry and a much more fragmented marketplace as compared to the military market. Potential additional competitors include start up companies providing low cost solutions.

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

UAS Regulation

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

Certain of these regulations impose substantial penalties for violations, including suspension or debarment from government contracting or subcontracting for a period of time. We monitor all of our contracts and contractual efforts to minimize the possibility of any violation of these regulations.

In addition, we are subject to industry specific regulations due to the nature of the products and services we provide. For example, certain aspects of our business are subject to further regulation by additional U.S. government authorities, including (i) the FAA, which regulates airspace for all air vehicles in the U.S. National Airspace System, (ii) the National Telecommunications and Information Administration and the Federal Communications Commission, which regulate the wireless communications upon which our UAS depend in the United States and (iii) the Defense Trade Controls of the U.S. Department of State that administers the International Traffic in Arms Regulations, which regulate the export of controlled technical data, defense articles and defense services.

The FAA issued the first restricted type certificate for the commercial operation of an unmanned aircraft over American soil to our Puma AE system in 2014. Under a COA, we operated Puma AE systems in the Prudhoe Bay area of Alaska to support a major oil and gas customer. The Secretary of Transportation has the authority to determine whether an airworthiness certificate is required for a UAS to operate safely in the U.S. National Airspace System. On September 25, 2014 the FAA began issuing case by case authorization for certain unmanned aircraft to perform commercial operations prior to the finalization of the rules providing for the integration of small UAS into the U.S. National Airspace System. As of May 11, 2015 the FAA had granted us four exemptions for the use of our small UAS, including Puma AE systems, for agriculture, aerial survey, and patrol operations and for inspections of fixed infrastructures in controlled environments. On June 21, 2016 the FAA released its final rules that allow routine use of certain small UAS in the U.S. National Airspace System. The FAA rules, which went into effect in August 2016, provide safety rules for small UAS (under 55 pounds) conducting non recreational operations. The rules limit flights to visual line of sight daylight operation, unless the UAS has anti-collision lights in which case twilight operation is permitted. The final rule also addresses height and speed restrictions, operator certification, optional use of a visual observer, aircraft registration and marking and operational limits, including prohibiting flights over unprotected people on the ground who are not directly participating in the operation of the UAS. Current FAA regulations require drone operators to register their systems with the FAA and secure operating licenses for their drones as per the Part 107 specifications. These regulations continue to evolve to accommodate the integration of UAS into the national airspace system for commercial applications, including HAPS UAS, that are designed to fly at very high altitudes for extended periods of time.

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

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UAS Government Contracting Process

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

UAS Bidding Process

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

UAS Funding

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

The U.S. military funds its contracts for our full rate production UAS either through operational need statements or as programs of record. Operational need statements require allocations of discretionary spending or reallocations of funding from other government programs. Funding for our production of initial Raven system deliveries, for example, was provided through operational need statements. We define a program of record as a program which, after undergoing extensive DoD review and product testing, is included in the five year government budget cycle, meaning that funding is allocated for purchases under these contracts during the five year cycle, absent affirmative action by the customer or Congress to change the budgeted amount. Despite being included in the five-year budget cycle, funding for these programs is subject to annual approval.

UAS Material Government Contract Provisions

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

- terminate existing contracts for convenience, in whole or in part, when it is in the interest of the government to do so;
- terminate contracts for default upon the occurrence of certain enumerated events;
- unilaterally modify contracts with regard to certain performance requirements;
- cancel multi year contracts and related orders, if funds for contract performance for any subsequent year become unavailable;
- potentially obtain rights in, or ownership to, intellectual property associated with products and systems developed or delivered by a contractor as a result of its performance of the contract;
- adjust contract costs and fees on the basis of audits completed by its agencies;
- suspend or debar a contractor from doing business with the U.S. government; and

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· control or prohibit the export of certain items.

Generally, government contracts are subject to oversight audits by government representatives. Compensation, if any, in the event of a termination for default is limited to payment for work completed at the time of termination. In the event of a termination for convenience, the contractor may receive the contract price for completed work, as well as its costs of performance of terminated work including an allowance for profit and reasonable termination settlement costs.

UAS Government Contract Categories

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

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

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

Cost Reimbursable. Cost reimbursable contracts include cost plus fixed fee contracts, cost plus award fee contracts and cost plus incentive fee contracts, each of which are described below. Under each type of contract, we assume the risk that we may not be able to recover costs if they are not allowable under the contract terms or applicable regulations, or if the costs exceed the contract funding.

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

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

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

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

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

UAS Indefinite Delivery Indefinite Quantity Contract Form

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

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

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

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Item 1A. Risk Factors.

General Business Risks

The proposed acquisition of the assets associated with our EES operating segment by Webasto may disrupt our business and, if this transaction is not completed, our stock price may decline and we will have incurred significant expenses.

On June 1, 2018, we entered into the Purchase Agreement with Webasto, pursuant to which Webasto has agreed to acquire certain properties, assets and rights used or held for use in connection with our EES Business. The transaction, whether or not consummated, may disrupt our sales and marketing or other business activities, including our relationships with customers, suppliers and other third parties, and divert management's and our employees' attention from our day-to-day operations, which may have an adverse impact on our financial performance. Further, the failure to complete the transaction may result in disruptions related to the re-integration of our EES Business, as well as a potential decline in employee morale. Alternatively, we could seek other strategic alternatives for the EES Business, such as a sale of the assets of the business to another party. We may not be successful in consummating such other strategic alternatives or on terms as favorable as the current proposed transaction with Webasto. Additionally, the employees of our EES Business, despite being offered employment with Webasto after the closing of the transactions contemplated by the Purchase Agreement, may decide to depart and seek alternative employment prior to the closing, which would have a negative impact on our ability to continue our operations.

The Purchase Agreement generally requires us to operate our EES Business in the ordinary course pending consummation of the transaction and places certain contractual restrictions on the conduct of our EES Business that may affect our ability to execute on our business strategy and attain our financial objectives. Additionally, we have incurred and will continue to incur substantial financial advisory, legal, and other professional fees and expenses in connection with the transaction, which we must pay regardless of whether the transaction is completed.

The obligations of the parties to complete the transaction with Webasto are subject to certain closing conditions, including: (i) the accuracy of each party's representations and warranties (subject to customary materiality qualifiers), (ii) each party's compliance with its covenants and agreements contained in the Purchase Agreement (subject to customary materiality qualifiers), (iii) the execution by the parties of certain ancillary agreements and (iv) other customary closing conditions, which are described in more detail in the Purchase Agreement, which will be filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ending July 29, 2018. In the event that any of the conditions set forth in the Purchase Agreement are not satisfied or waived to the extent permitted by applicable law or the transactions contemplated by the Purchase Agreement do not occur when or as expected, the price per share of our common stock could decline.

We will continue to be responsible for certain liabilities and obligations related to our EES business even if our proposed divestiture of the related assets is consummated.

Under our Purchase Agreement with Webasto, Webasto has assumed certain of our future obligations with respect to our EES business, although we will continue to be responsible for certain warranty, product and other liabilities arising prior to the closing of such transaction. If substantial unknown liabilities were to arise in the future, then our financial condition could be materially adversely affected. Further, we have agreed to indemnify Webasto for certain pre-closing liabilities associated with our EES business assets and for breaches of the representations and warranties contained in the Purchase Agreement for the transaction. There can be no guarantee that material claims will not arise during the relevant indemnification periods and that we will not have to provide the requisite indemnification. In addition, legal challenges to any potential claim for indemnification could result in increased legal expenses to us.

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

Historically, we have derived a significant portion of our total sales and substantially all of our small UAS sales from the U.S. government and its agencies. Sales to the U.S. government, either as a prime contractor or subcontractor, represented approximately 54% of our revenue for the fiscal year ended April 30, 2018. The DoD, our principal U.S.

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government customer, accounted for approximately 46% of our revenue for the fiscal year ended April 30, 2018. We believe that the success and growth of our business for the foreseeable future will continue to depend to a significant degree on our ability to win government contracts, in particular from the DoD. Many of our government customers are subject to budgetary constraints and our continued performance under these contracts, or award of additional contracts from these agencies, could be jeopardized by spending reductions, including constraints on government spending imposed by the Budget Control Act of 2011 and its subsequent amendments, or budget cutbacks at these agencies. The funding of U.S. government programs is uncertain and dependent on continued congressional appropriations and administrative allotment of funds based on an annual budgeting process. We cannot assure you that current levels of congressional funding for our products and services will continue and that our business will not decline. Additionally, the U.S. military funds our contracts primarily through operational needs statements, and to a lesser extent, through programs of record, which provides us with less visibility and certainty on future funding allocations for our contracts. Furthermore, all of our contracts with the U.S. government are terminable by the U.S. government at will. A significant decline in government expenditures generally, or with respect to programs for which we provide products, could adversely affect our business and prospects. Our operating results may also be negatively impacted by other developments that affect these government programs generally, including the following:

- changes in government programs that are related to our products and services;
- adoption of new laws or regulations relating to government contracting or changes to existing laws or regulations;
- changes in political or public support for security and defense programs;
- delays or changes in the government appropriations and budget process;
- uncertainties associated with the current global threat environment and other geo political matters; and
- delays in the payment of our invoices by government payment offices.

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

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

Over the last decade, operational activity in Afghanistan and Iraq led to adoption and an increase in demand for our small UAS. More recently, the U.S. military has reduced its presence and operational activity in Afghanistan and Iraq, reducing demand for certain of our small UAS products from prior levels. We cannot predict whether the reduction in overseas operational levels will continue, how future procurement priorities related to defense transformation will be impacted or how changes in the threat environment will impact opportunities for our small UAS business in terms of existing, additional or replacement programs. If defense transformation or overseas operations cease or slow down, then our business, financial condition and results of operations could be impacted negatively.

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

Our UAS are sold in new and rapidly evolving markets. The commercial UAS market is in the early stages of customer adoption. The market for HAPS UAS is also in an early stage of development. Accordingly, our business and future prospects may be difficult to evaluate. We cannot accurately predict the extent to which demand for our products will increase, if at all. The challenges, risks and uncertainties frequently encountered by companies in rapidly evolving markets could impact our ability to do the following:

· generate sufficient revenue to maintain profitability;

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· acquire and maintain market share;

· achieve or manage growth in our operations;

· develop and renew contracts;

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

· successfully develop and commercially market new products;

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

· access additional capital when required and on reasonable terms.

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

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

The defense industry is highly competitive and generally characterized by intense competition to win contracts. Our current principal small UAS competitors include Elbit Systems Ltd., L3 Technologies, Inc. and Lockheed Martin Corporation. We do not view large UAS such as Northrop Grumman Corporation's Global Hawk, General Atomics, Inc.'s Predator and related products, The Boeing Company's ScanEagle and Textron Inc.'s Shadow as direct competitors because they perform different missions, do not typically deliver their information directly to front line ground forces, and are not hand launched and controlled. However, we cannot be certain that these platforms will not become direct competitors in the future. The HAPS UAS market is in an early stage of development and our HAPS UAS faces competition from several aerospace and defense contractors and internet technology companies pursuing the high altitude long endurance UAS market for global communication and remote sensing, including The Boeing Company, Airbus, Lockheed Martin Corporation and Northrop Grumman Corporation, and competition from companies pursuing alternative solutions for this market such as Lockheed Martin Corporation and Northrop Grumman Corporation with airships (high altitude aircraft that are kept buoyant by a body of gas that is lighter than air) and companies pursuing conventional satellites and Low Earth Orbit, or LEO, micro or cubesat satellite constellations. Our tactical missile systems business faces competition from competitors including Textron Inc., Raytheon Company and Lockheed Martin Corporation.

Some of these firms have substantially greater financial, management, research and marketing resources than we have. Our UAS services business also faces competition from smaller businesses that can provide training and logistics services for multiple UAS platforms, including our small UAS.

Our competitors may be able to provide customers with different or greater capabilities or benefits than we can provide in areas such as technical qualifications, past contract performance, geographic presence, price and the availability of key professional personnel, including those with security clearances. Furthermore, many of our competitors may be able to utilize their substantially greater resources and economies of scale to develop competing products and technologies, manufacture in high volumes more efficiently, divert sales away from us by winning broader contracts or hire away our employees by offering more lucrative compensation packages. Small business competitors in our services businesses may be able to offer more cost competitive services, due to their lower overhead costs, and take advantage of small business incentive and set aside programs for which we are ineligible. In the event that the market for small UAS and services expands, we expect that competition will intensify as additional competitors enter the market and current competitors expand their product lines. In order to secure contracts successfully when competing with larger, well financed companies, we may be forced to agree to contractual terms that provide for lower aggregate payments to us over the life of the contract, which could adversely affect our margins. In addition, larger diversified competitors serving as prime contractors may be able to supply underlying products and services from affiliated entities, which would prevent us from competing for subcontracting opportunities on these contracts. Our failure to compete effectively

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with respect to any of these or other factors could have a material adverse effect on our business, prospects, financial condition or operating results.

If the UAS, tactical missile systems, and commercial UAS markets do not experience significant growth, if we cannot expand our customer base or if our products do not achieve broad acceptance, then we may not be able to achieve our anticipated level of growth.

We cannot accurately predict the future growth rates or sizes of the markets for our products. Demand for our products may not increase, or may decrease, either generally or in specific markets, for particular types of products or during particular time periods. We believe the market for commercial UAS is nascent. Moreover, there are only a limited number of major programs under which the U.S. military, our primary customer, is currently funding the development or purchase of our UAS and tactical missile systems. Although we have expanded our UAS customer base to include foreign governments, and domestic non military agencies, we cannot assure you that our continued efforts to further increase our sales to these customers will be successful. The expansion of the UAS, tactical missile systems, and commercial UAS markets in general, and the market for our products in particular, depends on a number of factors, including the following:

· customer satisfaction with these types of systems as solutions;

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

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

· limitations on our ability to market our UAS and tactical missile systems products and services outside the United States due to U.S. government regulations;

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

· marketing efforts and publicity regarding these types of systems.

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

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

We derived approximately 46% of our revenue from international sales, including U.S. government foreign military sales in which an end user is a foreign government, during the fiscal year ended April 30, 2018 compared to 37% for the fiscal year ended April 30, 2017. We expect to continue to derive an increasing portion of our revenue from international sales. Our international revenue and operations are subject to a number of material risks, including the following:

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

· regulatory requirements that may adversely affect our ability to operate in foreign jurisdictions, sell certain products or repatriate profits to the United States;

· the complexity and necessity of using foreign representatives and consultants;

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- the complexities of operating a business in an international location through a subsidiary or joint venture structure that may include foreign business partners, subcontractors and suppliers;

- the complexity of shipping our products internationally through multiple jurisdictions with varying legal requirements;

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

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

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

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

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

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

- different and changing legal and regulatory requirements, including those pertaining to anti-corruption, anti-boycott, data protection and privacy, employment law, intellectual property and contracts in the jurisdictions in which we currently operate or may operate in the future.

Negative developments in any of these areas in one or more countries could result in a reduction in demand for our products, the cancellation or delay of orders already placed, threats to our intellectual property, difficulty in collecting receivables and a higher cost of doing business, any of which could negatively impact our business, financial condition or results of operations. While we have adopted policies and procedures to facilitate compliance with laws and regulations applicable to our international sales, our failure, or the failure by our employees or others working on our behalf, to comply with such laws and regulations may result in administrative, civil or criminal liabilities, including suspension or debarment from government contracts or suspension of our export privileges. Moreover, our sales, including sales to customers outside the United States, substantially all are denominated in U.S. dollars, and downward fluctuations in the value of foreign currencies relative to the U.S. dollar may make our products more expensive than other products, which could harm our business.

We could be prohibited from shipping our products to certain countries if we are unable to obtain U.S. government authorization regarding the export of our products, or if current or future export laws limit or otherwise restrict our business. In addition, failure to comply with export laws could result in fines, export restrictions and other sanctions and penalties.

We must comply with U.S. and other laws regulating the export of our products. In some cases, explicit authorization from the relevant U.S. government authorities is needed to export our products. The export regulations and the governing policies applicable to our business are subject to change. We cannot provide assurance that such export authorizations will be available for our products in the future. Compliance with these laws has not significantly limited our operations or our sales in the recent past, but could significantly limit them in the future. We maintain an export compliance program but there are risks that our compliance controls may be ineffective. We have voluntarily disclosed export violations to the U.S. Department of State, a number of which are currently under review by the department. The State Department has imposed significant fines, penalties and sanctions, including suspension of export privileges, on companies that have violated the export laws. If the State Department determines that the conduct in our voluntary disclosures warrants the imposition of significant fines, penalties or sanctions, it could have a material adverse impact on our business, operations and financial condition and limit or prevent us from being able to sell our products in certain international jurisdictions.

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If we are unable to manage the increasing complexity of our business or achieve or manage our expected growth, our business could be adversely affected.

The complexity of our business has increased significantly over the last several years. We have expanded the number of business areas being pursued, shifting from primarily a U.S. government focused business to a business that includes substantial international product sales and added commercial services and formed a joint venture with SoftBank Corp. to develop HAPS UAS. This increased complexity and our expected growth has placed, and will continue to place, a strain on our management and our administrative, operational and financial infrastructure. We anticipate further growth of headcount and facilities will be required to address expansion in our product offerings and the geographic scope of our customer base. However, if we are unsuccessful in our efforts, our business could decline. Our success will depend in part upon the ability of our senior management to manage our increased complexity and expected growth effectively. To do so, we must continue to hire, train, manage and integrate a significant number of qualified managers and engineers. If our new employees perform poorly, or if we are unsuccessful in hiring, training, managing and integrating these new employees, or retaining these or our existing employees, then our business may experience declines.

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

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

Until recently, we have focused on selling our small UAS to the U.S. military. We have, however, expanded our small UAS sales into other government and commercial markets and formed a joint venture with SoftBank Corp. to develop HAPS UAS for global communication and remote sensing applications. Our efforts to expand our product offerings beyond our traditional markets may divert management resources from existing operations and require us to commit significant financial resources to unproven businesses that may not generate additional sales, either of which could significantly impair our operating results.

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

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

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

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

Our future growth depends on penetrating new markets, adapting existing products to new applications, and introducing new products and services that achieve market acceptance. We plan to incur substantial research and development costs as part of our efforts to design, develop and commercialize new products and services and enhance existing products. We spent $26.4 million, or 10% of our revenue, in our fiscal year ended April 30, 2018 on research and development activities. We believe that there are significant investment opportunities in a number of business areas.

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Because we account for research and development as an operating expense, these expenditures will adversely affect our earnings in the future. Further, our research and development programs may not produce successful results, and our new products and services may not achieve market acceptance, create additional revenue or become profitable, which could materially harm our business, prospects, financial results and liquidity.

Failure to obtain necessary regulatory approvals from the FAA or other governmental agencies, or limitations put on the use of small UAS in response to public privacy concerns, may prevent us from expanding the sales of our small UAS to non military customers in the United States.

The regulation of small UAS for commercial use in the United States is undergoing substantial change and the ultimate treatment is uncertain. In 2006, the FAA issued a clarification of its existing policies stating that, in order to engage in commercial use of small UAS in the U.S. National Airspace System, a public operator must obtain a COA from the FAA, or fly in restricted airspace. The FAA's COA approval process requires that the public operator certify the airworthiness of the aircraft for its intended purpose, that a collision with another aircraft or other airspace user is extremely improbable, that the small unmanned aircraft system complies with appropriate cloud and terrain clearances and that the operator or spotter of the small unmanned aircraft system is generally within one half mile laterally and 400 feet vertically of the small unmanned aircraft system while in operation. Furthermore, the FAA's clarification of existing policy stated that the rules for radio controlled hobby aircraft do not apply to public or commercial use of small UAS.

On February 14, 2012, the FAA Modernization and Reform Act of 2012 was enacted, establishing various deadlines for the FAA to allow expanded use of small UAS for both public and commercial applications. On June 21, 2016, the FAA released its final rules regarding the routine use of certain small UAS (under 55 pounds) in the U.S. National Airspace System pursuant to the act. The rules, which became effective in August 2016, provided safety regulations for small UAS conducting non recreational operations and contain various limitations and restrictions for such operations, including a requirement that operators keep UAS within visual-line-of-sight and prohibiting flights over unprotected people on the ground who are not directly participating in the operation of the UAS. We cannot assure you that these new rules will result in the expanded use of our small UAS by law enforcement or other non military government agencies or commercial entities and we may not be able to expand our sales of small UAS beyond our military customers, which could harm our business prospects.

In addition, there exists public concern regarding the privacy implications of U.S. commercial and law enforcement use of small UAS. This concern has included calls to develop explicit written policies and procedures establishing usage limitations. We cannot assure you that the response from regulatory agencies, customers and privacy advocates to these concerns will not delay or restrict the adoption of small UAS by non military customers.

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

Our UAS rely on complex avionics, sensors, user friendly interfaces and tightly integrated, electromechanical designs to accomplish their missions. Despite testing, our products have contained defects and errors and may in the future contain defects, errors or performance problems when first introduced, when new versions or enhancements are released, or even after these products have been used by our customers for a period of time. These problems could result in expensive and time consuming design modifications or warranty charges, delays in the introduction of new products or enhancements, significant increases in our service and maintenance costs, exposure to liability for damages, damaged customer relationships and harm to our reputation, any of which could materially harm our results of operations and ability to achieve market acceptance. In addition, increased development and warranty costs could be substantial and could reduce our operating margins.

The existence of any defects, errors, or failures in our products or the misuse of our products could also lead to product liability claims or lawsuits against us. A defect, error or failure in one of our UAS could result in injury, death or property damage and significantly damage our reputation and support for our UAS in general. We anticipate this risk will grow as our UAS begin to be used in U.S. domestic airspace and urban areas. We also remain liable for warranty and product liability claims for our EV charging systems and power cycling and test systems sold prior the closing of the transaction contemplated by the Purchase Agreement, which products have the potential to cause injury, death or

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property damage in the event that they are misused, malfunction or fail to operate properly due to unknown defects or errors.

Although we maintain insurance policies, we cannot provide assurance that this insurance will be adequate to protect us from all material judgments and expenses related to potential future claims or that these levels of insurance will be available in the future at economical prices or at all. A successful product liability claim could result in substantial cost to us. Even if we are fully insured as it relates to a claim, the claim could nevertheless diminish our brand and divert management's attention and resources, which could have a negative impact on our business, financial condition and results of operations.

If critical components or raw materials used to manufacture our products become scarce or unavailable, then we may incur delays in manufacturing and delivery of our products, which could damage our business.

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

In addition, certain raw materials and components used in the manufacture of our products are periodically subject to supply shortages, and our business is subject to the risk of price increases and periodic delays in delivery. Particularly, the market for electronic components is experiencing increased demand, creating substantial uncertainty regarding our suppliers' continued production of key components for our products. If we are unable to obtain components from third party suppliers in the quantities and of the quality that we require, on a timely basis and at acceptable prices, then we may not be able to deliver our products on a timely or cost effective basis to our customers, which could cause customers to terminate their contracts with us, increase our costs and seriously harm our business, results of operations and financial condition. Moreover, if any of our suppliers become financially unstable, or otherwise unable or unwilling to provide us with raw materials or components, then we may have to find new suppliers. It may take several months to locate alternative suppliers, if required, or to redesign our products to accommodate components from different suppliers. We may experience significant delays in manufacturing and shipping our products to customers and incur additional development, manufacturing and other costs to establish alternative sources of supply if we lose any of these sources or are required to redesign our products. We cannot predict if we will be able to obtain replacement components within the time frames that we require at an affordable cost, if at all.

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

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

We use estimates in accounting for many of our programs and changes in our estimates could adversely affect our future financial results.

Contract accounting requires judgments relative to assessing risks, including risks associated with estimating contract revenues and costs, assumptions for schedule and technical issues, customer directed delays and reductions in scheduled deliveries, and unfavorable resolutions of claims and contractual matters. Due to the size and nature of many

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of our contracts, the estimation of total revenues and cost at completion is complicated and subject to many variables. For example, we must make assumptions regarding the length of time to complete the contract because costs also include expected increases in wages and prices for materials; consider whether the intent of entering into multiple contracts was effectively to enter into a single project in order to determine whether such contracts should be combined or segmented; consider incentives or penalties related to performance on contracts in estimating sales and profit rates, and record them when there is sufficient information for us to assess anticipated performance; and use estimates of award fees in estimating sales and profit rates based on actual and anticipated awards. Because of the significance of the judgments and estimation processes described above, it is likely that materially different amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. Changes in underlying assumptions, circumstances or estimates may adversely affect our future results of operations and financial condition.

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

Fixed price contracts (including both government and commercial contracts) represented approximately 80% of our revenue for the fiscal year ended April 30, 2018. If we fail to anticipate technical problems, estimate costs accurately or control costs during our performance of fixed price contracts, then we may incur losses on these contracts because we absorb any costs in excess of the fixed price. Under cost plus fee contracts, if costs exceed the contract ceiling or are not allowable under the provisions of the contract or applicable regulations, then we may not be able to obtain reimbursement for all such costs. Under time and materials contracts, we are paid for labor at negotiated hourly billing rates and for certain expenses. Because many of our contracts involve advanced designs and innovative technologies, we may experience unforeseen technological difficulties and cost overruns. Under each type of contract, if we are unable to control the costs we incur in performing under the contract, then our financial condition and results of operations could be materially adversely affected. Cost overruns also may adversely affect our ability to sustain existing programs and obtain future contract awards.

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

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

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

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

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Our business may be dependent upon our employees obtaining and maintaining required security clearances, as well as our ability to obtain security clearances for the facilities in which we perform sensitive government work.

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

Our future profitability may be dependent upon achieving cost reductions and projected economies of scale from increasing manufacturing quantities of our products. Failing to achieve such reductions in manufacturing costs and projected economies of scale could materially adversely affect our business.

We have limited experience manufacturing small UAS and tactical missile systems in high volume. We do not know whether or when we will be able to develop efficient, low cost manufacturing capabilities and processes that will enable us to manufacture (or contract for the manufacture of) these products in commercial quantities while meeting the volume, speed, quality, price, engineering, design and production standards required to successfully market our products. Our failure to develop such manufacturing processes and capabilities in locations that can efficiently service our markets could have a material adverse effect on our business, financial condition, results of operations and prospects. Our future profitability is, in part, dependent upon achieving increased savings from volume purchases of raw materials and component parts, achieving acceptable manufacturing yield and capitalizing on machinery efficiencies. We expect our suppliers to experience a sharp increase in demand for their products. As a result, we may not have reliable access to supplies that we require or be able to purchase such materials or components at cost effective prices. There is no assurance that we will ever be in a position to realize any material, labor and machinery cost reductions associated with higher purchasing power and higher production levels. Failure to achieve these cost reductions could adversely impact our business and financial results.

We face significant risks in overseeing our outsourcing of manufacturing processes as well as in the management of our inventory, and failure to properly oversee our manufacturing processes or to effectively manage our inventory levels may result in product recalls or supply imbalances that could harm our business.

We have contracted for the manufacture of our Quantix UAS with contract manufacturers. We sell these units directly and through dealers. We face significant risks if our contract manufacturers do not perform as expected. If we fail to effectively oversee the manufacturing process, including the work performed by our contract manufacturers, we could be negatively impacted by product recalls, poorly performing products and higher than anticipated warranty costs.

In addition, we also maintain a variety of parts and components in inventory to allow us to customize our UAS products for specific customer requirements, which parts are subject to obsolescence and expiration. Due to the long lead time for obtaining certain UAS product components and the manufacturing cycles, we need to make forecasts of demand and commit significant resources towards manufacturing our products. As such, we are subject to significant risks in managing the inventory needs of our business during the year, including estimating the appropriate demand for our products. Should orders and market conditions differ significantly from our estimates, our future results of operations could be materially adversely affected. In the future, we may be required to record write downs of finished products and materials on hand and/or additional charges for excess purchase commitments as a result of future changes in our sales forecasts or customer orders.

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Due to the volatile and flammable nature of certain components of our products and equipment, fires or explosions may disrupt our business or cause significant injuries, which could adversely affect our financial results.

The development and manufacture of certain of our products involves the handling of a variety of explosive and flammable materials as well as high power equipment. From time to time, these activities may result in incidents that could cause us to temporarily shut down or otherwise disrupt some manufacturing processes, causing production delays and resulting in liability for workplace injuries and/or fatalities. We have safety and loss prevention programs that require detailed reviews of process changes and new operations, along with routine safety audits of operations involving explosive materials, to mitigate such incidents, as well as a variety of insurance policies, however our insurance coverage may be inadequate to cover all claims and losses related to such incidents. We may experience such incidents in the future, which could result in production delays or otherwise have a material adverse effect on our business and financial condition.

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

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

As a manufacturer of commercial UAS, we are subject to various government regulations and may be subject to additional regulations in the future, violation of which could subject us to sanctions or otherwise harm our business.

As a manufacturer of consumer products, we are subject to significant government regulations, including, in the United States, those issued under the Consumer Products Safety Act, as well as those issued under product safety and consumer protection statutes in our international markets. Failure to comply with any applicable product safety or consumer protection regulation could result in sanctions that could have a negative impact on our business, financial condition and results of operations.

Governments and regulatory agencies in the markets where we manufacture and sell products may enact additional regulations relating to product safety and consumer protection in the future, and may also increase the penalties for failure to comply with product safety and consumer protection regulations. In addition, one or more of our customers might require changes in our products, such as the non use of certain materials, in the future. Complying with any such additional regulations or requirements could impose increased costs on our business. Similarly, increased penalties for non compliance could subject us to greater expenses in the event any of our products were found to not comply with such regulations. Such increased costs or penalties could harm our business.

We could be the subject of future product liability suits or product recalls, which could harm our business.

We may be subject to involuntary product recalls or may voluntarily conduct a product recall. The costs associated with any future product recalls could be significant. In addition, any product recall, regardless of direct costs of the recall, may harm consumer perceptions of our products and have a negative impact on our future revenues and results of operations.

In addition to government regulation, products that have been or may be developed by us may expose us to potential liability from personal injury or property damage claims by the users of such products. There can be no assurance that a claim will not be brought against us in the future. While we maintain insurance coverage for product

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liability claims, our insurance may be inadequate to cover any such claims. Any successful claim could significantly harm our business, financial condition and results of operations. Further, we remain responsible for non-warranty costs of any recall of products we manufactured, sold or services prior to closing of the transaction with Webasto.

Our quarterly operating results may vary widely.

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

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

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

· the mix of products that we sell in the period;

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

· unanticipated costs incurred in the introduction of new products;

· fluctuations in the adoption of our products in new markets;

· our ability to win additional contracts from existing customers or other contracts from new customers;

· cancellations, delays or contract amendments by our U.S. governmental agency and foreign government customers;

· changes in policy or budgetary measures that adversely affect our U.S. governmental agency and foreign government customers;

· the cost of complying with various regulatory requirements applicable to our business and the potential penalties or sanctions that could be imposed for non compliance; and

· our ability to obtain the necessary export licenses for sales of our products and services to international customers.

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

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

We depend on our research and development activities to develop the core technologies used in our UAS products and for the development of our future products. A portion of our research and development activities depends on funding by commercial companies and the U.S. government. U.S. government and commercial spending levels can be impacted by a number of variables, including general economic conditions, specific companies' financial performance and competition for U.S. government funding with other U.S. government sponsored programs in the budget formulation and appropriation processes. To the extent that these external sources of funding are reduced or eliminated, company funding for research and development could be reduced. Any reductions in available research and development funding could harm our business, financial condition and operating results.

Our work for the U.S. government and international governments may expose us to security risks.

As a U.S. government contractor, we face various security threats, including cyber security attacks on our information technology infrastructure, attempts to gain access to our proprietary, financial, banking or classified information as well as threats to the physical security of our facilities and employees. Although we utilize various procedures and controls to monitor and mitigate these threats, there can be no assurance that these procedures and controls will be sufficient to prevent disruptions, the unauthorized release of confidential technical, financial or banking information or corruption of data. Accordingly, any significant operational delays, or any destruction, manipulation or improper use of our data, information systems or networks could adversely affect our financial results and damage the reputation for our products and services. Previous cyber-attacks directed at us have not materially impacted our business or financial results, but the impact of future incidents cannot be predicted due to the evolving nature and complexity of cyber-attacks. If we or our partners are subject to data security breaches, we may have a loss in sales or increased costs arising from the restoration or implementation of additional security measures, either of which could materially and adversely affect our business and financial results. Additionally, expenses resulting from cyber security attacks and other security risks may not be fully insured or otherwise mitigated, which could harm our financial results.

In addition, we work in international locations where there are high security risks, which could result in harm to our employees and contractors or substantial costs. Some of our services are performed in or adjacent to high risk locations, such as Iraq and Afghanistan, where the country or location is experiencing political, social or economic issues, or war or civil unrest. In those locations where we have employees or operations, we may incur substantial costs to maintain the safety of our personnel. Despite these precautions, the safety of our personnel in these locations may continue to be at risk, and we may in the future be negatively impacted by the loss of employees and contractors, which could harm our business and operating results.

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

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

· hire additional engineers and other personnel;

· develop new or enhance existing products;

· enhance our operating infrastructure;

· fund working capital requirements;

· acquire complementary businesses or technologies; or

· otherwise respond to competitive pressures.

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

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

As of April 30, 2018, our $2.1 million of long term investments recorded at fair value consisted entirely of auction rate municipal bonds with maturities that range from approximately 1 to 16 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.

Since fiscal 2008, we have experienced failed auctions of our auction rate securities and there is no assurance that auctions on the remaining auction rate securities in our investment portfolio will succeed in the future. As a result, our ability to liquidate our investments in the near term may be limited, and our ability to recover the carrying value of our investments may be limited. An auction failure means that the parties wishing to sell securities were not able to do so. As of June 15, 2018, including the securities involved in failed auctions, we held approximately $1.9 million of these auction rate securities, all of which carry investment grade ratings. These investments are subject to general credit, liquidity, market and interest rate risks, which may be exacerbated by problems in the global credit markets. These and other related factors have affected various sectors of the financial markets and caused credit and liquidity issues. If the issuers of these securities are unable to successfully close future auctions or their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. We currently believe these securities are not permanently impaired, primarily due to the government backing of the underlying securities. However, it could take until the final maturity of the underlying notes (up to 16 years) to realize our remaining investments' purchase price of $2.0 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.

Our cash may be subject to a risk of loss and we may be exposed to fluctuations in the market values of our portfolio investments and in interest rates.

Our assets include a significant amount of cash and investments. We adhere to an investment policy set by our Board of Directors which aims to preserve our financial assets, maintain adequate liquidity and maximize returns. We believe that our cash is held in institutions whose credit risk is minimal and that the value and liquidity of our deposits are accurately reflected in our consolidated financial statements as of April 30, 2018. We currently invest the majority of our cash in U.S. government securities, U.S. government agency securities, municipal bonds and high-grade corporate bonds, the performance of which are subject to additional market risks related to their respective issuers.

Nearly all of our cash and bank deposits are not insured by the Federal Deposit Insurance Corporation, or the FDIC. Therefore, our cash and any bank deposits that we now hold or may acquire in the future may be subject to risks, including the risk of loss or of reduced value or liquidity. In the future, should we determine that there is a decline in value of any of our portfolio securities which is not temporary in nature, this would result in a loss being recognized in our consolidated statements of operations.

Unstable market and economic conditions may have serious adverse consequences on our business, financial condition and stock price.

Global credit and financial markets have experienced extreme disruptions in recent years, including severely diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates and uncertainty about economic stability. There can be no assurance that renewed deterioration in credit and financial markets and confidence in economic conditions will not occur. Our general business strategy may be

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adversely affected by any economic downturn, volatile business environment or continued unpredictable and unstable market conditions. If the current equity and credit markets deteriorate, or do not improve, it may make any necessary debt or equity financing more difficult, more costly and more dilutive. Failure to secure any necessary financing in a timely manner and on favorable terms could have a material adverse effect on our growth strategy, financial performance and stock price and could require us to delay or abandon implementing business initiatives. These events and the continuing market upheavals could adversely affect our business in a number of ways, including:

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

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

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

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

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

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

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

- diversion of financial and management resources from existing operations;

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

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

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

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· assumption of unanticipated problems or latent liabilities, such as problems with the quality of the target company’s products or its regulatory compliance; and

· inability to generate sufficient revenue to offset acquisition costs.

Acquisitions also frequently result in the recording of goodwill and other intangible assets which are subject to potential impairments in the future that could harm our financial results. In addition, if we finance acquisitions by issuing equity, or securities convertible into equity, then our existing stockholders may be diluted, which could lower the market price of our common stock. If we finance acquisitions through debt, then such future debt financing may contain covenants or other provisions that limit our operational or financial flexibility.

If we fail to properly evaluate acquisitions or investments, then we may not achieve the anticipated benefits of any such acquisitions, and we may incur costs in excess of what we anticipate. The failure to successfully evaluate and execute acquisitions or investments or otherwise adequately address these risks could materially harm our business and financial results.

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

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

Our business is subject to federal, state and international laws regarding data protection and privacy, as well as confidentiality obligations under various agreements, and a privacy breach could damage our reputation, expose us to litigation risk and adversely affect our business.

In connection with our business, we receive, collect, process and retain certain sensitive and confidential customer information. As a result, we are subject to increasingly rigorous federal, state and international laws regarding privacy and data protection. We also execute confidentiality agreements with various parties under which we are required to protect their confidential information. Compliance with these agreements and constantly evolving laws may cause us to incur significant costs or require changes to our business practices, which could reduce our revenue. If we fail to comply with these privacy and data protection laws, proceedings may be brought against us by governmental entities or others or penalties may be imposed on us, either of which could have a material adverse effect on our business, results of operations and financial condition. In addition, we could be subject to damages if we breach the confidentiality obligations in our agreements. While we rely, in part, on security services and software provided by outside vendors to protect sensitive and confidential customer information, there is no guarantee that the protections that we, or our outside vendors have implemented will prevent security breaches. In addition, we have access to certain of our customers' proprietary systems that contain sensitive information and are liable to such customers for damages caused by or employees' and agents' misuse of or access to such systems, including damages resulting from security breaches to such customers' systems caused by us. Any actual, threatened or perceived security breach that could result

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in misappropriation, loss or other unauthorized disclosure of sensitive or confidential customer information could harm our reputation and relationship with customers and potential customers, expose us to litigation risk and liability and adversely affect our business.

Compliance with the SEC's conflict minerals regulations may increase our costs and adversely impact the supply chain for our UAS products.

In August 2012, the SEC adopted disclosure rules regarding a company's use of conflict minerals in its products with substantial supply chain verification requirements in the event that the conflict minerals come from, or could have come from, the Democratic Republic of the Congo or adjoining countries. These rules and verification requirements will impose additional costs on us and on our suppliers, including costs related to determining the source of conflict minerals used in our products, which will adversely affect our results of operations. We are dependent on information supplied by our first tier suppliers in conducting due diligence into the origins of conflict minerals in our products and in complying with our SEC reporting obligations. To the extent that information we receive from our suppliers is inaccurate or inadequate, we may not be able to determine whether our products are conflict mineral free. We may face challenges in satisfying our customers who may require that our products be certified as conflict mineral free, which could place us at a competitive disadvantage and could harm our business. These regulations could also have the effect of limiting the pool of suppliers from which we source items containing conflict minerals, and we may be unable to obtain conflict free minerals at competitive prices, if at all, which could increase our costs and adversely affect our results of operations.

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

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

We self-insure a portion of our health insurance program which may expose us to unexpected costs and negatively affect our results of operations.

We are self-insured for employee medical claims, subject to individual and aggregate stop loss insurance policies. We estimate a liability for claims filed and incurred but not reported based upon recent claims experience and an analysis of the average period of time between the occurrence of a claim and the time it is reported to and paid by us. However, unanticipated changes in assumptions and management estimates underlying our recorded liabilities for medical claims could result in materially different amounts of expense than expected under our health insurance program, which could have an adverse material impact on our financial condition and results of operations.

Risks Related to Our U.S. Government Contracts

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

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

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

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

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

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

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

- the Federal Aviation Administration, which regulates the use of airspace for all aircraft, including UAS operation in the United States;

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

- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes or determined to be “controlled unclassified information” and the exportation of certain products and technical data.

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

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

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

Like most government contractors, our contracts are audited and reviewed on a continual basis by the DCMA and the DCAA. The indirect costs we incur in performing government contracts have been audited on an annual basis. The DCMA, disallowed a portion of the our executive compensation and other costs included in our fiscal 2006, 2007 and 2008 incurred cost claims and sought interest for all three years and penalties for fiscal 2006, based on the disallowed costs. We appealed these cost disallowances to the Armed Services Board of Contract Appeals. For fiscal 2006, as a result of partial settlements and a decision of the Armed Services Board of Contract Appeals in March 2016, the government's remaining claims were dismissed with prejudice. All of the government's claims related to our 2007 and 2008 incurred cost claims were settled as of October 2015 by payment to the government of $50,000 and the government's claims related to our 2009 incurred cost claims were settled as of October 2015 without the payment of any consideration. The audit of our 2010 incurred cost claim was settled in April 2016 without payment of any consideration. Our incurred cost claims for fiscal years 2011 through 2014 were accepted as submitted during the fiscal year ended April 30, 2017. No consideration was paid. In addition, non audit reviews or investigations by the government may still be conducted on all of our government contracts.

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Any costs found to be improperly allocated to a specific cost reimbursement contract will not be reimbursed, while such costs already reimbursed must be refunded. If an audit or investigation of our business were to uncover improper or illegal activities, then we could be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, suspension of payments, fines and suspension or debarment from doing business with the U.S. government. We could experience serious harm to our reputation if allegations of impropriety or illegal acts were made against us, even if the allegations were inaccurate. In addition, responding to governmental audits or investigations may involve significant expense and divert management attention. If any of the foregoing were to occur, our financial condition and operating results could be materially adversely affected.

Moreover, if any of our administrative processes and business systems are found not to comply with the applicable requirements, we may be subjected to increased government scrutiny or required to obtain additional governmental approvals that could delay or otherwise adversely affect our ability to compete for or perform contracts. In December 2015, DCMA concluded that our purchasing system was not approved. In an April 2016 follow-up review the DCMA approved our purchasing system. An unfavorable outcome to such an audit or investigation by the DCAA, U.S. Department of Justice or DOJ, or other government agency, could materially adversely affect our competitive position, affect our ability to obtain new government business, and obtain the maximum price for our products and services, and result in a substantial reduction of our revenues.

If we were suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating results could be materially harmed. For example, in February 2010, we were notified by the DOJ that it had initiated a civil investigation into our cost charging practices with respect to government contracts. We resolved these claims with the DOJ in October 2013. Under the settlement agreement, we reimbursed the government for an amount erroneously charged to the government in our fiscal 2006 incurred cost claim submittal.

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

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

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

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

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

In addition, U.S. government contracts generally contain provisions permitting termination, in whole or in part, at the government's convenience or for contractor default. Since a substantial majority of our revenue is dependent on the procurement, performance and payment under our U.S. government contracts, the termination of one or more critical

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government contracts could have a negative impact on our results of operations and financial condition. Termination arising out of our default could result in damage to our reputation, expose us to liability and have a material adverse effect on our ability to re compete for future contracts and orders. Moreover, several of our contracts with the U.S. government do not contain a limitation of liability provision, creating a risk of responsibility for indirect, incidental damages and consequential damages. These provisions could cause substantial liability for us, especially given the use to which our products may be put.

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

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

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

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

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

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

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

We are subject to procurement rules and regulations, which increase our performance and compliance costs under our U.S. government contracts.

We must comply with, and are affected by, laws and regulations relating to the formation, administration and performance of U.S. government contracts. These laws and regulations, among other things, require certification and disclosure of all cost and pricing data in connection with contract negotiation, define allowable and unallowable costs and otherwise govern our right to reimbursement under certain cost based U.S. government contracts, and restrict the use and dissemination of classified information and the exportation of certain products and technical data. These requirements, although customary in U.S. government contracts, increase our performance and compliance costs. These costs might increase in the future, reducing our margins, which could have a negative effect on our financial condition. Although we believe we have procedures in place to comply with these regulations and requirements, the regulations and requirements are complex and change frequently. Failure to comply with these regulations and requirements under certain circumstances could lead to suspension or debarment from U.S. government contracting or subcontracting for a period of time and could have a negative effect on our reputation and ability to receive other U.S. government contract awards in the future.

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Risks Related to Our Intellectual Property

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

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

In addition, affirmatively defending our intellectual property rights and investigating whether any of our products or services violate the rights of others may entail significant expense. Our intellectual property rights may be challenged by others or invalidated through administrative processes or litigation. If we resort to legal proceedings to enforce our intellectual property rights or to determine the validity and scope of the intellectual property or other proprietary rights of others, then the proceedings could result in significant expense to us and divert the attention and efforts of our management and technical employees, even if we prevail.

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

We may become subject to claims that our technologies infringe upon the intellectual property or other proprietary rights of third parties. Defending against, or otherwise addressing, any such claims, whether they are with or without merit, could be time consuming and expensive, and could divert our management’s attention away from the execution of our business plan. Moreover, any settlement or adverse judgment resulting from these claims could require us to pay substantial amounts or obtain a license to continue to use the disputed technology, or otherwise restrict or prohibit our use of the technology. We cannot assure you that we would be able to: obtain from the third party asserting the claim a license on commercially reasonable terms, if at all; develop alternative technology on a timely basis, if at all; or obtain a license to use a suitable alternative technology to permit us to continue offering, and our customers to continue using, our affected product. An adverse determination also could prevent us from offering our products to others. Infringement claims asserted against us may have a material adverse effect on our business, results of operations or financial condition.

Risks Relating to Securities Markets and Investment in Our Stock

The price of our common stock may fluctuate significantly.

The market prices for securities of emerging technology companies have historically been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the

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operating performance of particular companies. The market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot control, including the following:

- U.S. government spending levels, both generally and by our particular customers;
- the volume of operational activity by the U.S. military;
- delays in the payment of our invoices by government payment offices, resulting in potentially reduced earnings during a particular fiscal quarter;
- announcements of new products or technologies, commercial relationships or other events relating to us or our industry or our competitors;
- failure of any of our key products to gain market acceptance;
- variations in our quarterly operating results;
- perceptions of the prospects for the markets in which we compete;
- changes in general economic conditions;
- changes in securities analysts' estimates of our financial performance;
- regulatory developments in the United States and foreign countries;
- fluctuations in stock market prices and trading volumes of similar companies;
- news about the markets in which we compete or regarding our competitors;
- terrorist acts or military action related to international conflicts, wars or otherwise;
- sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders; and

· additions or departures of key personnel.

In addition, the equity markets in general, and NASDAQ in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies. Further, the market prices of securities of emerging technology companies have been particularly volatile. These broad market and industry factors may affect the market price of our common stock adversely, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation often has been instituted against that company. This type of litigation, if instituted against us, could result in substantial costs and a diversion of management's attention and resources.

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

As of June 20, 2018, our directors, executive officers and their affiliates collectively beneficially owned 2,813,865 shares, or approximately 12%, of our total outstanding shares of common stock. Accordingly, our directors and executive officers as a group may be able to exert significant influence over matters requiring stockholder approval, including the election of directors. The interests of our directors and executive officers may not be fully aligned with yours. Although there is no agreement among our directors and executive officers with respect to the voting of their shares, this concentration of ownership may delay, defer or even prevent a change in control of our company, and make

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transactions more difficult or impossible without the support of all or some of our directors and executive officers. These transactions might include proxy contests, tender offers, mergers or other purchases of common stock that could give you the opportunity to realize a premium over the then prevailing market price for shares of our common stock.

Delaware law and anti takeover provisions in our organizational documents may discourage our acquisition by a third party, which could make it more difficult to acquire us and limit your ability to sell your shares at a premium.

Our certificate of incorporation and bylaws contain certain provisions that reduce the probability of a change of control or acquisition of our company, even if such a transaction would be beneficial to our stockholders. These provisions include, but are not limited to:

- The ability of our board of directors to issue preferred stock in one or more series of with such rights, obligations and preferences as the board may determine, without further vote or action by our stockholders;
- Advanced notice procedures for stockholders to nominate candidates for election to the board of directors and for stockholders to submit proposals for consideration at a meeting of stockholders;
- The absence of cumulative voting rights for our stockholders;
- The classification of our board of directors, which effectively prevents stockholders from electing a majority of the directors at any one annual meeting of stockholders;
- The limitation that directors may be removed only for cause by the affirmative vote of the holders of $66^2/_3$% of the total voting power of all of our outstanding securities entitled to vote in the election of directors, voting together as a single class; and
- Restrictions on the ability of our stockholders to call a special meeting of stockholders.

We are also subject to Section 203 of the Delaware General Corporation Law which, subject to certain exceptions, prohibits “business combinations” between a publicly held Delaware corporation and an “interested stockholder,” which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation’s voting stock for a three year period following the date that such stockholder became an interested stockholder. This statute, as well as the provisions in our organizational documents, could have the effect of delaying, deterring or preventing certain potential acquisitions or a change in control of us.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

All of our facilities are leased. Our corporate headquarters are located in Monrovia, California where we lease approximately 36,000 square feet under an agreement expiring in June 2024. We have several other leased facilities in California, Alabama and Virginia that are used for administration, research and development, logistics and manufacturing and have a total of approximately 375,000 square feet. Such leases expire between the end of 2018 and 2025. We believe that our facilities are adequate to meet our needs for the foreseeable future.

Effective March 28, 2018, we entered into a lease agreement to lease approximately 94,280 square feet of space in Moorpark, California to serve as a new facility for the design, engineering, testing, and manufacturing of unmanned aircraft systems. As of April 30, 2018, the lease term had not commenced and we had no operations at the facility.

As of April 30, 2018 our business had significant operations at the following locations:

· UAS: Simi Valley, California; and Huntsville, Alabama

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- EES: Monrovia, California; and Simi Valley, California. In conjunction with the closing of the purchase agreement, we will enter into sub-lease agreements with the purchaser for all or portions of these EES facilities.

- Corporate functions: Monrovia, California; and Simi Valley, California

Item 3. Legal Proceedings.

On April 18, 2018, a former employee of AeroVironment, Mark Anderson, filed a lawsuit against us and Wahid Nawabi, our President and Chief Executive Officer, in the Superior Court of the State of California for the County of Los Angeles. Mr. Anderson's claims include whistle blower retaliation, race discrimination and wrongful termination related to the termination of his employment with the Company. Mr. Anderson is seeking special damages, general damages, punitive damages, attorneys' fees and other relief the court deems just and proper. We believe the complaint contains legal claims that are without merit. We will defend ourselves vigorously once we are served with the complaint.

We are subject to lawsuits, government investigations, audits and other legal proceedings from time to time in the ordinary course of our business. It is not possible to predict the outcome of any legal proceeding with any certainty. The outcome or costs we incur in connection with a legal proceeding could adversely impact our operating results and financial position.

Item 4. Mine Safety Disclosure.

Not applicable.

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PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Common Stock

The following table sets forth, for the periods indicated, the high and low sales prices for our common stock from May 1, 2016 through April 30, 2018. The following quotations reflect inter dealer prices, without retail mark up, mark down or commission, and may not represent actual transactions.

	Fiscal Year Ended April 30,			
	2018		2017	
	High	Low	High	Low
First Quarter	$ 40.10	$ 28.13	$ 32.44	$ 26.02
Second Quarter	$ 55.75	$ 36.71	$ 30.08	$ 22.16
Third Quarter	$ 58.99	$ 41.53	$ 29.42	$ 23.40
Fourth Quarter	$ 58.06	$ 41.60	$ 29.96	$ 25.42

On June 20, 2018, the closing sales price of our common stock as reported on the NASDAQ Global Select Market was $57.90 per share. As of June 20, 2018, there were 94 holders of record of our common stock.

Dividends

To date we have retained all earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. Any future determination related to dividend policy will be made at the discretion of our board of directors and will depend upon, among other factors, our results of operations, financial condition, capital requirements, capital allocation policy, expected return on invested capital, contractual restrictions and such other factors as our board of directors deems relevant.

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Stock Price Performance Graph

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

The following table shows the value of $100 invested on April 30, 2013 in AeroVironment, Inc., the Russell 2000 Index and the SPADE Defense Index.

	Performance Graph Table ($)					
	April 30, 2013	April 30 2014	April 30, 2015	April 30, 2016	April 30 2017	April 30, 2018
AeroVironment Stock	100	174	132	149	148	282
Russell 2000 Index	100	119	129	119	148	164
SPADE Defense Index	100	136	156	156	193	242

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

Issuer Purchases of Equity Securities

On September 24, 2015, we announced that on September 23, 2015 our Board of Directors authorized a share repurchase program (the "Share Repurchase Program"), pursuant to which we may repurchase up to $25 million of our common stock from time to time, in amounts and at prices we deem appropriate, subject to market conditions and other considerations. Share repurchases may be executed through open market transactions or negotiated purchases and may

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be made under a Rule 10b5-1 plan. There is no expiration date for the program. The Share Repurchase Program does not obligate us to acquire any particular amount of common stock and may be suspended at any time by our Board of Directors. We did not repurchase any shares during the fiscal year ended April 30, 2018. As of April 30, 2018, approximately $21.2 million remained authorized for future repurchases under this program.

Item 6. Selected Consolidated Financial Data.

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

	Year Ended April 30,				
	2018	2017	2016	2015	2014
	(In thousands, except per share data)				
Consolidated Income Statement Data:					
Revenue	$ 271,052	$ 228,940	$ 233,738	$ 220,951	$ 208,810
Net income from continuing operations attributable to AeroVironment	$ 22,576	$ 16,633	$ 15,393	$ 11,682	$ 25,659
Earnings per common share from continuing operations attributable to AeroVironment:					
Basic	$ 0.97	$ 0.72	$ 0.67	$ 0.51	$ 1.14
Diluted	$ 0.95	$ 0.72	$ 0.67	$ 0.50	$ 1.10
Weighted average common shares outstanding (basic):	23,471	23,059	22,936	22,869	22,354
Weighted average common shares outstanding (diluted):	23,814	23,308	23,153	23,146	22,719
Balance Sheet Data					
Total assets	$ 472,911	$ 432,500	$ 410,393	$ 397,467	$ 384,954
Capital lease obligations, current portion	$ 161	$ 288	$ 390	$ —	$ —
Capital lease obligations, net of current portion	$ —	$ 161	$ 449	$ —	$ —
Other long-term obligations	$ 2,274	$ 2,083	$ 2,339	$ 1,712	$ 4,546

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

Introduction

The following discussion of our financial condition and results of operations should be read in conjunction with our "Selected Consolidated Financial Data" and our consolidated financial statements and notes thereto included herein as Item 8. This discussion contains forward looking statements. Refer to "Forward Looking Statements" on page 2 and "Risk Factors" beginning on page 19, for a discussion of the uncertainties, risks and assumptions associated with these statements.

On June 1, 2018, we entered into an Asset Purchase Agreement ("the Purchase Agreement") with Webasto Charging Systems, Inc. ("Webasto") pursuant to which we agreed to sell, and Webasto agreed to acquire, substantially all of the assets of our Efficient Energy Systems (the "EES Business") and to assume certain liabilities related to the EES Business. The closing of the transactions contemplated by the Purchase Agreement is subject to certain closing conditions, including: (i) the accuracy of each party's representations and warranties (subject to customary materiality qualifiers), (ii) each party's compliance with its covenants and agreements contained in the Purchase Agreement (subject to customary materiality qualifiers), (iii) the execution by the parties of certain ancillary agreements and (iv) other customary closing conditions. We anticipate that the transaction will close within our first quarter of fiscal 2019. As of April 30, 2018, we determined that the EES Business met the criterion for classification as an asset held for sale and represents a strategic shift in in our operations. Therefore, the assets and liabilities and the results of operations of the EES Business are reported in this Annual Report as discontinued operations for all periods presented.

Overview

We design, develop, produce, support and operate a technologically advanced portfolio of products. We supply unmanned aircraft systems ("UAS") and related services to organizations within the U.S. Department of Defense ("DoD") and to international allied governments, and tactical missile systems and related services primarily to organizations within the U.S. Government. We derive the majority of our revenue from these business areas and we believe that the markets for these solutions have significant growth potential. Additionally, we believe that some of the innovative potential products in our research and development pipeline will emerge as new growth platforms in the future, creating additional market opportunities.

The success we have achieved with our current products and services stems from our investment in research and development and our ability to invent and deliver advanced solutions, utilizing our proprietary technologies, to help our government, commercial and consumer customers operate more effectively and efficiently. We develop these highly innovative solutions by working very closely with our key customers and solving their most important challenges related to our areas of expertise. Our core technological capabilities, developed through more than 45 years of innovation, include lightweight aerostructures, power electronics, electric propulsion systems, efficient electric power generation, conversion, and storage systems, high density energy packaging, miniaturization, DDL, aircraft payloads, controls integration, systems integration and engineering optimization coupled with professional field service capabilities.

Our UAS business focuses primarily on the design, development, production, marketing, support and operation of innovative UAS and tactical missile systems and the delivery of UAS-related services that provide situational awareness, remote sensing, multi band communications, force protection and other information and mission effects to increase the safety and effectiveness of our customers' operations.

Revenue

We generate our revenue primarily from the sale, support and operation of our small UAS and tactical missile systems. Support for our small UAS customers includes training, spare parts, product repair, product replacement, and the customer contracted operation of our small UAS by our personnel. We refer to these support activities, in conjunction with customer funded research and development ("R&D"), as our services operation. We derive most of our small UAS revenue from fixed price and cost plus fee contracts with the U.S. government.

Cost of Sales

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

Gross Margin

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

Selling, General and Administrative

Our selling, general and administrative expenses, or SG&A, include salaries and other expenses related to selling, marketing and proposal activities, and other administrative costs. Some SG&A expenses relate to market and

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business development activities that support both ongoing business areas as well as new and emerging market areas. These activities can be directly associated with developing requirements for and applications of capabilities created in our R&D activities. SG&A is an important financial metric that we analyze to help us evaluate the contribution of our selling, marketing and proposal activities to revenue generation.

Research and Development Expense

R&D, is an integral part of our business model. We normally conduct significant internally funded R&D. Our R&D activities focus specifically on creating capabilities that support our existing product portfolio as well as new solutions.

Other Income and Expenses

Other income and expenses includes interest income, interest expense, amortization of capital lease payments, changes in fair value of certain financial investments, gains/losses on sale of available for sale equity securities, and gains resulting from the purchase of a controlling interest in an entity formerly accounted for under the equity method.

Income Tax Expense

Our effective tax rates are lower than the statutory rates primarily due to research and development tax credits partially offset by the impact of the Tax Cut and Jobs Act of 2017.

Equity Method Investment Activity, Net of Tax

Equity method investment activity, net of tax, includes equity method gain or loss related to the HAPSMobile, Inc. joint venture we formed in December 2017 with Softbank Corp, and our investment in Altoy Savunma Sanayi ve Havacilik Anonim Sirketi (“Altoy”) prior to obtaining a controlling interest on February 1, 2017.

Loss from Discontinued Operations, Net of Tax

On June 1, 2018, we entered into the Purchase Agreement with Webasto pursuant to which we agreed to sell, and Webasto agreed to acquire, substantially all of the assets of our EES Business and to assume certain liabilities related to the EES Business. We anticipate that the transaction will close within our first quarter of fiscal 2019. As of April 30, 2018, we determined that the EES Business met the criterion for classification as an asset held for sale and represents a strategic shift in in our operations. Therefore, the assets and liabilities and the results of operations of the EES Business are reported in this Annual Report as discontinued operations for all periods presented.

Net Loss Attributable to Noncontrolling Interests

Net loss attributable to noncontrolling interests includes the 15% interest in the income or losses of our Turkish joint venture, Altoy. We acquired a controlling interest in Altoy on February 1, 2017.

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

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of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting estimates affect our more significant judgments and estimates used in preparing our consolidated financial statements. Please see Note 1 to our consolidated financial statements, which are included in Item 8 “Financial Statements and Supplementary Data” of this Annual Report, for our Organization and Significant Accounting Policies. There have been no material changes made to the critical accounting estimates during the periods presented in the consolidated financial statements.

Revenue Recognition

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management’s estimates change on the basis of development of the business or market conditions. Management judgments and estimates have been applied consistently and have been reliable historically. We believe that there are two key factors which impact the reliability of management’s estimates. The first of those key factors is that the terms of our contracts are typically less than six months. The short term nature of such contracts reduces the risk that material changes in accounting estimates will occur on the basis of market conditions or other factors. The second key factor is that we have hundreds of contracts in any given accounting period, which reduces the risk that any one change in an accounting estimate on one or several contracts would have a material impact on our consolidated financial statements or our two reporting segments’ measures of profit.

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

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

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

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

We review cost performance and estimates to complete at least quarterly and in many cases more frequently. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur. The impact of revisions in profit estimates for all types of contracts are recognized on a cumulative catch up basis in the period in which the revisions are made. During the fiscal years ended April 30, 2018, 2017 and 2016, changes in accounting estimates on fixed price contracts recognized using the percentage of completion method of accounting are presented below. Amounts representing contract change orders or claims are included in revenue only when they can be reliably estimated and their realization is probable. Incentives or penalties and awards applicable to performance on contracts are considered in estimating revenue and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance.

For the years ended April 30, 2018, 2017 and 2016, favorable and unfavorable cumulative catch up adjustments included in cost of sales were as follows (in thousands):

	Year Ended April 30,		
	2018	2017	2016
Gross favorable adjustments	$ 1,195	$ 464	$ 479
Gross unfavorable adjustments	(847)	(318)	(210)
Net adjustments	$ 348	$ 146	$ 269

For the year ended April 30, 2018, favorable cumulative catch up adjustments of $1.2 million were primarily due to final cost adjustments on 14 contracts, which individually were not material. For the same period, unfavorable cumulative catch up adjustments of $0.8 million were primarily related to higher than expected costs on 5 contracts, which individually were not material.

For the year ended April 30, 2017, favorable cumulative catch up adjustments of $0.5 million were primarily due to final cost adjustments on 52 contracts, which individually were not material. For the same period, unfavorable cumulative catch up adjustments of $0.3 million were primarily related to higher than expected costs on 9 contracts, which individually were not material.

For the year ended April 30, 2016, favorable cumulative catch up adjustments of $0.5 million were primarily due to final cost adjustments on 19 contracts, which individually were not material. For the same period, unfavorable cumulative catch up adjustments of $0.2 million were primarily related to higher than expected costs on 15 contracts, which individually were not material.

Inventories and Reserve for Excess and Obsolescence

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

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Self Insured Liability

We are self insured for employee medical claims, subject to individual and aggregate stop loss policies. We estimate a liability for claims filed and incurred but not reported based upon recent claims experience and an analysis of the average period of time between the occurrence of a claim and the time it is reported to and paid by us. We perform an annual evaluation of this policy and have determined that for all prior years during which this policy has been in effect there have been cost advantages to this policy, as compared to obtaining commercially available employee medical insurance. However, actual results may differ materially from those estimated and could have a material impact on our consolidated financial statements.

Impairment of Long Lived Assets

We review the recoverability of long lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance, and may differ from actual cash flows. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made.

Intangible Assets – Acquired in Business Combinations

We perform valuations of assets acquired and liabilities assumed on each acquisition accounted for as a business combination and allocate the purchase price of each acquired business to our respective net tangible and intangible assets. Acquired intangible assets include: customer relationships and trade names. We use valuation techniques to value these intangibles assets, with the primary technique being a discounted cash flow analysis. A discounted cash flow analysis requires us to make various assumptions and estimates including projected revenue, gross margins, operating costs, growth rates, useful lives and discount rates. Intangible assets are amortized over their estimated useful lives using the straight-line method which approximates the pattern in which the economic benefits are consumed.

Long Term Incentive Awards

For our outstanding long-term incentive plans as of April 30, 2018, we grant long-term incentive awards and we establish a target payout at the beginning of each performance period. The actual payout at the end of the performance period is calculated based upon our achievement of such targets. Payouts are made in cash and restricted stock units. Upon vesting of the restricted stock units, we have the discretion to settle the restricted stock units in cash or stock.

The cash component of the award is accounted for as a liability. The equity component is accounted for as a stock-based liability as the restricted stock units may be settled in cash or stock. At each reporting period, we reassess the probability of achieving the performance targets. The estimation of whether the performance targets will be achieved requires judgment, and to the extent actual results or updated estimates differ from our current estimates, the cumulative effect on current and prior periods of those changes will be recorded in the period estimates are revised.

Income Taxes

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

We have various foreign subsidiaries to conduct or support our business outside the United States. We do not provide for U.S. income taxes on undistributed earnings for our foreign subsidiaries as management expects the foreign earnings will be indefinitely reinvested in such foreign jurisdictions.

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We followed the guidance in SEC Staff Accounting Bulletin 118 (“SAB 118”), which provides additional clarification regarding the application of ASC Topic 740 in situations where we do not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) for the reporting period in which the Act was enacted. SAB 118 provides for a measurement period beginning in the reporting period that includes the Act’s enactment date and ending when the Company has obtained, prepared, and analyzed the information needed in order to complete the accounting requirements but in no circumstances should the measurement period extend beyond one year from the enactment date.

Fiscal Periods

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

Results of Operations

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

	Fiscal Year Ended April 30,								
	2018			2017			2016		
Revenue	$ 271,052	100	%	$ 228,940	100	%	$ 233,738	100	%
Cost of sales	162,164	60	%	133,755	58	%	128,164	55	%
Gross margin	108,888	40	%	95,185	42	%	105,574	45	%
Selling, general and administrative	50,826	19	%	47,642	21	%	50,463	22	%
Research and development	26,433	10	%	28,465	12	%	35,040	15	%
Income from continuing operations	31,629	12	%	19,078	8	%	20,071	9	%
Interest income, net	2,240	1	%	1,618	1	%	1,032	—	%
Other (expense) income, net	(49)	—	%	172	—	%	(2,589)	(1)	%
Income from continuing operations before income taxes	33,820	12	%	20,868	9	%	18,514	8	%
Income tax expense	10,177	4	%	4,138	2	%	2,983	—	%
Equity method investment activity, net of tax	(1,283)	—	%	(119)	—	%	(138)	—	%
Net income from continuing operations	22,360	8	%	16,611	7	%	15,393	7	%

Loss from discontinued operations, net of tax	(2,508)	(1)	%	(4,154)	(2)	%	(6,427)	(3)	%
Net income	19,852	7	%	12,457	5	%	8,966	4	%
Net loss attributable to noncontrolling interest	216	—	%	22	—	%	—	—	%
Net income attributable to AeroVironment	$ 20,068	7	%	$ 12,479	5	%	$ 8,966	4	%

Fiscal Year Ended April 30, 2018 Compared to Fiscal Year Ended April 30, 2017

Revenue. Revenue for the fiscal year ended April 30, 2018 was $271.1 million, as compared to $228.9 million for the fiscal year ended April 30, 2017, representing an increase of $42.2 million, or 18%. The increase in revenue was due to an increase in product deliveries of $35.7 million and an increase in customer-funded R&D work of $8.2 million, partially offset by a decrease in service revenue of $1.7 million. The increase in product deliveries was primarily due to an increase in product deliveries of small UAS to international customers and to customers within the U.S. government and product deliveries of tactical missile systems to customers within the U.S. government. The increase in customer-funded R&D was primarily associated with our design and development agreement with HAPSMobile, partially offset

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by a decrease in tactical missile systems and tactical missile system variant programs. The decrease in service revenue was primarily due to a decrease in sustainment activities in support of tactical missile system product deliveries.

Cost of Sales. Cost of sales for the fiscal year ended April 30, 2018 was $162.2 million, as compared to $133.8 million for the fiscal year ended April 30, 2017, representing an increase of $28.4 million, or 21%. The increase in cost of sales was a result of an increase in product cost of sales of $23.0 million and an increase in service costs of sales of $5.4 million. The increase in product costs was primarily due to the increase in product deliveries. The increase in service costs of sales was primarily due to the increase in service revenue. As a percentage of revenue, cost of sales increased from 58% to 60%, primarily due to an unfavorable mix in both products and services and an increase in inventory reserve charges.

Gross Margin. Gross margin for the fiscal year ended April 30, 2018 was $108.9 million, as compared to $95.2 million for the fiscal year ended April 30, 2017, representing an increase of $13.7 million, or 14%. The increase in gross margin was primarily due to an increase in product margins of $12.7 million and an increase in service margins of $1.0 million. The increase in product margins was primarily due to the increase in product deliveries. The increase in services margins was primarily due to the increase in customer-funded R&D revenue. As a percentage of revenue, gross margin decreased from 42% to 40%, primarily due to an unfavorable mix in both products and services and an increase in inventory reserve charges.

Selling, General and Administrative. SG&A expense for the fiscal year ended April 30, 2018 was $50.8 million, or 19% of revenue, compared to SG&A expense of $47.6 million, or 21% of revenue, for the fiscal year ended April 30, 2017. The increase in SG&A expense was primarily due to an increase in bonus expense associated with our fiscal 2018 financial results, the recording of impairment charges related to the identifiable intangible assets and goodwill of Altoy during the three months ended October 28, 2017, an increase in bad debt expense and an increase in legal expenses, partially offset by a decrease in sales commission expense as a result of a decrease in the number of international small UAS contracts under which we utilized sales agents.

Research and Development. R&D expense for the fiscal year ended April 30, 2018 was $26.4 million, or 10% of revenue, compared to R&D expense of $28.5 million, or 12% of revenue, for the fiscal year ended April 30, 2017. R&D expense decreased primarily due to decreased development activities for certain strategic initiatives.

Interest Income, net. Interest income, net for the fiscal year ended April 30, 2018 was $2.2 million, compared to $1.6 million for the fiscal year ended April 30, 2017. The increase in interest income was primarily due to an increase in the average interest rates earned on our investments portfolio.

Other Income (Expense), net. Other expense, net for the fiscal year ended April 30, 2018 was $49,000, as compared to other income, net of $0.2 million for the fiscal year ended April 30, 2017.

Income Taxes. Our effective income tax rate was 30.1% for the fiscal year ended April 30, 2018, as compared to 19.8% for the fiscal year ended April 30, 2017. The provision for income taxes for the fiscal year ended 2018 included the impact of the Tax Cut and Jobs Act of 2017, inclusive of a reduction in the blended fiscal year 2018 federal statutory tax rate from 35% to 30.4% and an estimated $3.4 million one-time expense resulting from the remeasurement of our deferred tax assets and liabilities.

Equity method investment activity, net of tax. Equity method investment activity, net of tax for the fiscal year ended April 30, 2018 was a loss of $1.3 million, as compared to equity method investment activity, net of tax loss of $0.1 million for the fiscal year ended April 30, 2017. The increase was due to the equity method loss associated with our investment in the HAPSMobile joint venture formed in December 2017. Equity method investment activity, net of tax for the fiscal year ended April 30, 2017 related to our investment in Altoy prior to obtaining a controlling interest in February 2017.

Loss from discontinued operations, net of tax. Loss from discontinued operations, net of tax for the fiscal year ended April 30, 2018 was a loss of $2.5 million as compared to a loss from discontinued operations, net of tax of $4.2

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million for the fiscal year ended April 30, 2017. The loss from discontinued operations, net of tax relates to the results of our EES Business.

Fiscal Year Ended April 30, 2017 Compared to Fiscal Year Ended April 30, 2016

Revenue. Revenue for the fiscal year ended April 30, 2017 was $228.9 million, as compared to $233.7 million for the fiscal year ended April 30, 2016, representing a decrease of $4.8 million, or 2%. The decrease in revenue was primarily due to a decrease in customer funded R&D of $9.9 million and a decrease in product deliveries of $2.4 million, partially offset by an increase in service revenue of $7.5 million. The decrease in customer funded R&D was primarily associated with tactical missile system variant programs. The decrease in product deliveries was primarily due to a decrease in product deliveries of small UAS, partially offset by an increase in product deliveries of tactical missile systems. The increase in service revenue was primarily due to an increase in services associated with tactical missile systems and an increase in sustainment activities in support of small UAS for our international customers. In fiscal 2017, we continued to experience expansion in small UAS product deliveries and related services to international customers and in tactical missile system product deliveries and related services to customers within the U.S. Government.

Cost of Sales. Cost of sales for the fiscal year ended April 30, 2017 was $133.8 million, as compared to $128.2 million for the fiscal year ended April 30, 2016, representing an increase of $5.6 million, or 4%. As a percentage of revenue, cost of sales increased from 55% to 58%. The increase in cost of sales was a result of an increase in product cost of sales of $3.9 million and an increase in service costs of sales of $1.7 million, both of which were impacted by the reserve reversal of $3.2 million for the settlement of prior year government incurred cost audits recorded in the second quarter of fiscal 2016 as well as an increase in sustaining engineering activities in support of our existing products, partially offset by decreases in customer-funded R&D and decreases in product deliveries.

Gross Margin. Gross margin for the fiscal year ended April 30, 2017 was $95.2 million, as compared to $105.6 million for the fiscal year ended April 30, 2016, representing a decrease of $10.4 million, or 10%. As a percentage of revenue, gross margin decreased from 45% to 42%. The decrease in gross margin was a result of a decrease in product margin of $6.3 million and a decrease in service margin of $4.1 million, both of which were impacted by the reserve reversal of $3.2 million for the settlement of prior year government incurred cost audits recorded in the second quarter of fiscal 2016.

Selling, General and Administrative. SG&A expense for the fiscal year ended April 30, 2017 was $47.6 million, or 21% of revenue, compared to SG&A expense of $50.5 million, or 22% of revenue, for the fiscal year ended April 30, 2016. The decrease in SG&A expense was primarily due to a decrease in bid and proposal costs and a decrease in professional services expenses, partially offset by an increase in sales commission expense as a result of our increased international small UAS revenues.

Research and Development. R&D expense for the fiscal year ended April 30, 2017 was $28.5 million, or 12% of revenue, compared to R&D expense of $35.0 million, or 15% of revenue, for the fiscal year ended April 30, 2016. R&D expense decreased primarily due to decreased development activities for certain strategic initiatives.

Interest Income, net. Interest income, net for the fiscal year ended April 30, 2017 was $1.6 million, compared to $1.0 million for the fiscal year ended April 30, 2016. The increase in interest income was primarily due to an increase in the average interest rates earned on our investments portfolio.

Other Income (Expense), net. Other income, net for the fiscal year ended April 30, 2017 was $0.2 million, as compared to other expense, net of $2.6 million for the fiscal year ended April 30, 2016. The increase in other income was primarily due to the recording of an other-than-temporary impairment loss on our CybAero equity securities during the first quarter of fiscal 2016. Other income, net for the fiscal year ended April 30, 2017 also included a gain of $0.6 million related to the acquisition of a controlling interest in our Turkish Joint Venture, Altoy.

Income Taxes. Our effective income tax rate was 19.8% for the fiscal year ended April 30, 2017, as compared to 16.1% for the fiscal year ended April 30, 2016. The increase in the effective tax rate was primarily a result of an increase in income before taxes and a decrease in tax credits as a result of federal legislation permanently reinstating the federal research and development tax credit retroactive to January 2015 during fiscal year 2016, partially offset by a reversal of a reserve of $1.0 million for uncertain tax positions due to the settlement of prior fiscal year audits recorded in the first quarter of fiscal 2017.

Equity method investment activity, net of tax. Equity method investment activity, net of tax for the fiscal year ended April 30, 2017 and April 30, 2016 was a loss of $0.1 million. The losses related to the equity method investment in our Turkish Joint Venture, Altoy prior to obtaining a controlling interest in February 2017.

Loss from discontinued operations, net of tax. Loss from discontinued operations, net of tax for the fiscal year ended April 30, 2017 was a loss of $4.2 million as compared to loss from discontinued operations, net of tax of $6.4 million for the fiscal year ended April 30, 2016. Loss from discontinued operations, net of tax relates to the results of our EES Business.

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. 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. We anticipate that existing sources of liquidity and cash flows from operations will be sufficient to satisfy our cash needs for the foreseeable future.

Our primary liquidity needs are for financing working capital, investing in capital expenditures, supporting product development efforts, introducing new products and enhancing existing products, and marketing acceptance and adoption of our products and services. Our future capital requirements, to a certain extent, are also subject to general conditions in or affecting the defense industry and are subject to general economic, political, financial, competitive, legislative and regulatory factors that are beyond our control. Moreover, to the extent that existing cash, cash equivalents, cash from operations, and cash from short term borrowing are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. In addition, we may also need to seek additional equity funding or debt financing if we become a party to any agreement or letter of intent for potential investments in, or acquisitions of, businesses, services or technologies.

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.

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Cash Flows

The following table provides our cash flow data from continuing operations for the periods ended:

	Fiscal Year Ended April 30,		
	2018	2017	2016
	(In thousands)		
Net cash provided by (used in) operating activities	$ 70,436	$ (7,995)	$ 6,047
Net cash used in investing activities	$ (6,397)	$ (36,516)	$ (15,950)
Net cash provided by (used in) financing activities	$ 2,020	$ 3,470	$ (3,096)

Cash Provided by Operating Activities. Net cash provided by operating activities for the fiscal year ended April 30, 2018 increased by $78.4 million to $70.4 million, compared to net cash used in operating activities of $8.0 million for the fiscal year ended April 30, 2017. This increase in net cash provided by operating activities was primarily due to an increase in the cash provided as a result of changes in operating assets and liabilities of $63.7 million largely resulting from decreases in accounts receivable due to year over year timing differences in revenue and related collections, and decreases in inventory primarily due to year over year timing differences in purchases to support anticipated product deliveries, an increase in non-cash expenses of $8.9 million, primarily due to the $3.4 million charge resulting from the remeasurement of our deferred tax assets and liabilities, an increase in stock-based compensation, and the equity method loss associated with the our HAPS JV, and an increase in net income from continuing operations of $5.7 million.

Net cash used in operating activities for the fiscal year ended April 30, 2017 increased by $14.0 million to $8.0 million, compared to net cash provided by operating activities of $6.0 million for the fiscal year ended April 30, 2016. This increase in net cash used in operating activities was primarily due to an increase in the use of cash as a result of changes in operating assets and liabilities of $14.4 million largely resulting from increases in inventory primarily due to year over year timing differences in purchases to support anticipated product deliveries, partially offset by an increase in net income of $1.2 million.

Cash Used in Investing Activities. Net cash used in investing activities decreased by $30.1 million to $6.4 million for the fiscal year ended April 30, 2018, compared to net cash used in investing activities of $36.5 million for the fiscal year ended April 30, 2017. The decrease in net cash used in investing activities was primarily due to lower net purchases of held to maturity investments of $33.4 million, partially offset by the investment in our HAPSMobile joint venture. During the fiscal years ended April 30, 2018, 2017 and 2016, we used cash to purchase property and equipment totaling $9.6 million, $9.0 million and $6.1 million, respectively.

Net cash used in investing activities increased by $20.5 million to $36.5 million for the fiscal year ended April 30, 2017, compared to net cash used in investing activities of $16.0 million for the fiscal year ended April 30, 2016. The increase in net cash used in investing activities was primarily due to higher net purchases of held to maturity investments of $16.9 million and an increase in capital expenditures of $2.9 million. During the fiscal years ended April 30, 2017, and 2016, we used cash to purchase property and equipment totaling $9.0 million and $6.1 million, respectively.

Cash Provided by (Used in) Financing Activities. Net cash provided by financing activities decreased by $1.5 million to $2.0 million for the fiscal year ended April 30, 2018, compared to net cash provided by financing activities of $3.5 million for the fiscal year ended April 30, 2017. The decrease was primarily due to a decrease in the cash provided from the exercise of employee stock options of $1.2 million.

Net cash provided by financing activities increased by $6.6 million to $3.5 million for the fiscal year ended April 30, 2017, compared to net cash used in financing activities of $3.1 million for the fiscal year ended April 30, 2016. The increase was primarily due to a decrease in the purchase and retirement of common stock of $3.8 million and an increase in cash provided from the exercise of employee stock options of $2.7 million.

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Contractual Obligations

The following table describes our commitments to settle contractual obligations as of April 30, 2018:

	Payments Due By Period				
		Less Than			More Than
	Total	1 Year	1 to 3 Years	3 to 5 Years	5 Years
	(In thousands)				
Operating lease obligations	$ 21,199	$ 4,940	$ 8,646	$ 5,699	$ 1,914
Capital lease obligations	161	161	—	—	—
Purchase obligations(1)	48,236	48,236	—	—	—
Total	$ 69,596	$ 53,337	$ 8,646	$ 5,699	$ 1,914

(1) Consists of all cancelable and non cancelable purchase orders as of April 30, 2018.
(2) Not included in the table above is an additional capital contribution of 209,500,000 yen (approximately $1,900,000) in or around January 2019 required under our HAPSMobile Inc. Joint Venture Agreement.

Off Balance Sheet Arrangements

As of April 30, 2018 we had no off balance sheet arrangements as defined in Item 303(a)(4) of the SEC's Regulation S K.

Inflation

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

Recently Adopted Accounting Standards

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This ASU does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. This ASU eliminates from U.S. GAAP the requirement to measure inventory at the lower of cost or market. Market under the previous requirement could be replacement cost, net realizable value, or net realizable value less a normal profit margin. Entities within the scope of this update will now be required to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory using LIFO or the retail inventory method. Our adoption of ASU 2015-11 effective May 1, 2017 did not have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the test for goodwill impairment by removing Step 2 from the goodwill impairment test. If goodwill impairment is realized, the amount recognized will be the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized cannot exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 must be applied on a prospective basis and will become effective for public entities in the first quarter of the year ending July 31, 2020, with early adoption available. We elected to early adopt the standard during the three months ended October 28, 2017. Our adoption of ASU 2017-04 did not have a material impact on our consolidated financial statements.

New Accounting Standards

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In January 2017, the FASB issued ASU 2017-01, Business Combinations – Clarifying the definition of a business (Topic 805). This ASU clarifies the definition of a business with the objective of providing a more robust framework to evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance will be effective for fiscal years beginning after December 15, 2017, including interim periods within that fiscal year, with early adoption permitted. The amendments are to be applied prospectively to business combinations that occur after the effective date.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230). This ASU adds and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2017 and interim periods therein, with early adoption permitted. We are evaluating the potential impact of this adoption on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This ASU requires the lessee to recognize the assets and liabilities for the rights and obligations created by leases with terms of 12 months or more. The guidance is effective for fiscal years beginning after December 15, 2018 and interim periods therein, with early adoption permitted. We are evaluating the potential impact of this adoption on our consolidated financial statements. We currently do not hold a large number of leases that are classified as operating leases under the existing lease standard, with the only significant leases being our various property leases. We are evaluating the potential impact of this adoption on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new standard was originally effective for reporting periods beginning after December 15, 2016 and early adoption was not permitted. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606)-Deferral of the Effective Date. This update approved a one-year delay of the effective date to reporting periods beginning after December 15, 2017, while permitting companies to voluntarily adopt the new standard as of the original effective date. Since the issuance of ASU 2014- 09, the FASB has issued several amendments to provide additional supplemental guidance on certain aspects of the original pronouncement. The core principle of ASU 2014-09 is to recognize revenue upon the transfer of goods or services to customers at an amount that reflects the consideration expected to be received. In adopting the guidance, companies are permitted to select between two transition methods: (1) a full retrospective transition method with the application of the new guidance to each prior reporting period presented, or (2) a retrospective transition method that recognizes the cumulative effect on prior periods at the date of adoption together with additional footnote disclosures.

Contracts for product deliveries of our tactical missile systems that we have historically recognized revenue as the related products were delivered will recognize revenue under the new standard over time as costs are incurred. In addition, services performed under contracts for both our tactical missile systems and small UAS that we have historically recognized revenue upon customer acceptance will recognize revenue under the new standard over time using an appropriate measure of progress, which is generally as costs are incurred. The new standard will not change the total amount of revenue recognized on these contracts, it will only accelerate the timing of when the revenue is recognized, resulting in an increase to unbilled receivables. The timing of cost of sales recognition for these contracts will also be accelerated, resulting in a decrease in inventories.

The new standard will not have a significant impact to revenue recognition for product deliveries of our small UAS family of systems that have historically recognized revenue as the related products were delivered. Under the new standard we will recognize revenue for these contracts at a point in time when the products transfer to the customer.

The new standard will not have a significant impact to revenue recognition for our customer-funded research and development contracts that we have historically recognized revenue based on percentage of completion. Under the new standard we will recognize revenue for these contracts over time as costs are incurred which approximates percentage of completion.

We will adopt ASU 2014-09 in the first quarter of 2019 using the full retrospective transition method which will require our fiscal year 2016 and 2017 financial statements to be revised. As described above, certain contracts under the new standard will recognize revenue as costs are incurred (or other appropriate measure of progress as applicable) as

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compared to as units are delivered under ASC 605 – Revenue Recognition, which will result in an increase in revenue from continuing operations of approximately $4.2 million in fiscal year 2017. The revision will also result in a cumulative adjustment from continuing operations to increase retained earnings by approximately $0.7 million and $1.8 million for the fiscal years ended April 30, 2016 and 2017, respectively.

The majority of the contracts in our discontinued EES business are product purchase order, bill and ship arrangements that we have historically recognized revenue as the related products were delivered. We do not anticipate a significant impact to revenue recognition under the new standard.

Due to the significant amount of revenues that occurred during the fourth quarter of fiscal 2018, we are continuing to assess the impact of adopting the new standard to our fiscal 2018 financial statements.

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

Interest Rate Risk

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

Foreign Currency Exchange Rate Risk

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

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Item 8. Financial Statements and Supplementary Data.

AeroVironment, Inc.

Audited Consolidated Financial Statements

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of AeroVironment, Inc. and subsidiaries (the Company) as of April 30, 2018 and 2017, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended April 30, 2018, and the related notes and financial statement schedule listed in the index at Item 15(a) (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company at April 30, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended April 30, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of April 30, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated June 26, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1999.

Los Angeles, California

June 26, 2018

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AEROVIRONMENT, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands except share data)

	April 30, 2018	2017
Assets		
Current assets:		
Cash and cash equivalents	$ 143,517	$ 79,904
Short-term investments	113,649	119,971
Accounts receivable, net of allowance for doubtful accounts of $1,080 at April 30, 2018 and $104 at April 30, 2017	56,813	68,719
Unbilled receivables and retentions (inclusive of related party unbilled receivables of $3,145 at April 30, 2018)	13,076	14,120
Inventories, net	38,640	40,908
Prepaid expenses and other current assets	5,103	5,533
Current assets of discontinued operations	28,349	24,930
Total current assets	399,147	354,085
Long-term investments	40,656	42,096
Property and equipment, net	19,219	15,962
Deferred income taxes	11,168	15,089
Other assets	2,721	2,010
Long-term assets of discontinued operations	—	3,258
Total assets	$ 472,911	$ 432,500
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 21,340	$ 15,896
Wages and related accruals	16,851	10,947
Income taxes payable	4,085	1,418
Customer advances	2,145	2,057
Other current liabilities	6,892	8,444
Current liabilities of discontinued operations	9,184	9,301
Total current liabilities	60,497	48,063
Deferred rent	1,536	1,719
Capital lease obligations - net of current portion	—	161
Other non-current liabilities	622	184
Deferred tax liability	67	116
Liability for uncertain tax positions	49	64
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.0001 par value:		
Authorized shares—10,000,000; none issued or outstanding at April 30, 2018 and April 30, 2017	—	—
Common stock, $0.0001 par value:		
Authorized shares—100,000,000		

Issued and outstanding shares—23,908,736 shares at April 30, 2018 and 23,630,419 at April 30, 2017	2	2
Additional paid-in capital	170,139	162,150
Accumulated other comprehensive loss	(21)	(127)
Retained earnings	239,997	219,929
Total AeroVironment stockholders' equity	410,117	381,954
Noncontrolling interest	23	239
Total equity	410,140	382,193
Total liabilities and stockholders’ equity	$ 472,911	$ 432,500

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands except share and per share data)

	Year Ended April 30,		
	2018	2017	2016
Revenue:			
Product sales	$ 195,330	$ 159,630	$ 162,032
Contract services (inclusive of related party revenue of $29,597 for the year ended April 30, 2018)	75,722	69,310	71,706
	271,052	228,940	233,738
Cost of sales:			
Product sales	111,990	88,963	85,089
Contract services	50,174	44,792	43,075
	162,164	133,755	128,164
Gross margin:			
Product sales	83,340	70,667	76,943
Contract services	25,548	24,518	28,631
	108,888	95,185	105,574
Selling, general and administrative	50,826	47,642	50,463
Research and development	26,433	28,465	35,040
Income from continuing operations	31,629	19,078	20,071
Other income (expense):			
Interest income, net	2,240	1,618	1,032
Other (expense) income, net	(49)	172	(2,589)
Income from continuing operations before income taxes	33,820	20,868	18,514
Provision (benefit) for income taxes	10,177	4,138	2,983
Equity method investment activity, net of tax	(1,283)	(119)	(138)
Net income from continuing operations	22,360	16,611	15,393
Loss from discontinued operations, net of tax	(2,508)	(4,154)	(6,427)
Net income	19,852	12,457	8,966
Net loss attributable to noncontrolling interest	216	22	—
Net income attributable to AeroVironment	$ 20,068	$ 12,479	$ 8,966
Net income (loss) per share attributable to AeroVironment - Basic			
Continuing operations	$ 0.97	$ 0.72	$ 0.67
Discontinued operations	(0.11)	(0.18)	(0.28)
Net income per share attributable to AeroVironment - Basic	$ 0.86	$ 0.54	$ 0.39
Net income (loss) per share attributable to AeroVironment - Diluted			
Continuing operations	$ 0.95	$ 0.72	$ 0.67
Discontinued operations	(0.11)	(0.18)	(0.28)
Net income per share attributable to AeroVironment - Diluted	$ 0.84	$ 0.54	$ 0.39
Weighted-average shares outstanding:			
Basic	23,471,241	23,059,045	22,936,413

Diluted	23,813,772	23,307,738	23,153,493

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Year Ended April 30,		
	2018	2017	2016
Net income	$ 19,852	$ 12,457	$ 8,966
Other comprehensive income:			
Change in foreign currency translation adjustments	36	-	-
Unrealized gain on investments, net of deferred tax expense of $25, $43, and $18 for the fiscal years ended 2018, 2017, and 2016 respectively	70	74	27
Total comprehensive income	19,958	12,531	8,993
Net loss attributable to noncontrolling interest	216	22	—
Comprehensive income attributable to AeroVironment	$ 20,174	$ 12,553	$ 8,993

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands except share data)

	Common Stock Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total AeroVironment Equity	Non-Controlling Interest	Total
Balance at April 30, 2015	23,314,640	2	148,293	201,975	(1,358)	348,912	—	348,912
Net income	—	—	—	8,966	—	8,966	—	8,966
Unrealized gain on investments	—	—	—	—	27	27	—	27
Reclassifications out of accumulated other comprehensive loss	—		—	—	1,130	1,130	—	1,130
Stock options exercised	84,881	—	1,122	—	—	1,122	—	1,122
Restricted stock awards	191,548	—	—	—	—	—	—	—
Restricted stock awards forfeited	(46,753)	—	—	—	—	—	—	—
Tax withholding payment related to net share settlement of equity awards	(1,130)	—	(29)	—	—	(29)	—	(29)
Reclassification from share-based liability compensation to equity	—		228	—	—	228	—	228
Tax benefit from stock-based compensation	—	—	98	—	—	98	—	98
Purchases of common stock for retirement	(183,261)		—	(3,756)	—	(3,756)	—	(3,756)
Stock-based compensation	—	—	4,562	—	—	4,562	—	4,562

Balance at April 30, 2016	23,359,925	2	154,274	207,185	(201)	361,260	—	361,260
Adoption of ASU 2016-09	—		—	265	—	265	—	265
Net income (loss)	—	—	—	12,479	—	12,479	(22)	12,457
Unrealized gain on investments	—	—	—	—	74	74	—	74
Stock options exercised	204,130	—	3,865	—	—	3,865	—	3,865
Restricted stock awards	126,557	—	—	—	—	—	—	—
Restricted stock awards forfeited	(60,017)	—	—	—	—	—	—	—
Tax withholding payment related to net share settlement of equity awards	(176)	—	(5)	—	—	(5)	—	(5)
Reclassification from share-based liability compensation to equity	—	—	307	—	—	307	—	307
Business acquisition	—	—	—	—	—	—	261	261
Stock-based compensation	—	—	3,709	—	—	3,709	—	3,709
Balance at April 30, 2017	23,630,419	2	162,150	219,929	(127)	381,954	239	382,193
Net income (loss)	—	—	—	20,068	—	20,068	(216)	19,852
Unrealized gain on investments	—	—	—	—	70	70	—	70
Foreign currency translation	—	—	—	—	36	36	—	36
Stock options exercised	153,211	—	2,705	—	—	2,705	—	2,705
Restricted stock awards	140,787	—	—	—	—	—	—	—
Restricted stock awards forfeited	(6,834)	—	—	—	—	—	—	—
Tax withholding payment related to net share settlement of equity awards	(8,847)	—	(397)	—	—	(397)	—	(397)
Reclassification from	—	—	384	—	—	384	—	384

share-based liability compensation to equity								
Stock based compensation	—	—	5,297	—	—	5,297	—	5,297
Balance at April 30, 2018	23,908,736	$ 2	$ 170,139	$ 239,997	$ (21)	$ 410,117	$ 23	$ 410,140

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended April 30,		
	2018	2017	2016
Operating activities			
Net income	$ 19,852	$ 12,457	$ 8,966
Loss from discontinued operations, net of tax	(2,508)	(4,154)	(6,427)
Net income from continuing operations	22,360	16,611	15,393
Adjustments to reconcile net income to cash provided by (used in) operating activities:			
Depreciation and amortization	5,982	5,054	3,855
Loss from equity method investments	1,283	119	138
Impairment of available-for-sale securities	—	—	2,186
Impairment of long-lived assets	255	46	—
Provision for doubtful accounts	977	48	18
Impairment of intangible assets and goodwill	1,021	—	—
(Gains) losses on foreign currency transactions	(87)	284	63
Loss on sale of equity securities	—	—	219
Deferred income taxes	3,835	(52)	(2,912)
Gain on business acquisition	—	(584)	—
Stock-based compensation	4,956	3,392	4,002
Tax benefit from exercise of stock options	—	—	161
Excess tax benefit from exercise of stock options	—	—	(39)
Loss (Gain) on disposition of property and equipment	20	44	—
Amortization of held-to-maturity investments	1,424	2,382	3,875
Changes in operating assets and liabilities:			
Accounts receivable	11,211	(19,608)	(20,645)
Unbilled receivables and retentions	903	4,667	(1,555)
Inventories	2,268	(19,225)	480
Prepaid expenses and other assets	419	(1,484)	439
Accounts payable	5,736	545	(2,851)
Other liabilities	7,872	(233)	3,221
Net cash provided by (used in) operating activities of continuing operations	70,436	(7,994)	6,047
Investing activities			
Acquisition of property and equipment	(9,563)	(9,017)	(6,121)
Equity method investments	(3,267)	—	(295)
Business acquisitions, net of cash acquired	—	(430)	—
Redemptions of held-to-maturity investments	227,663	121,522	84,433
Purchases of held-to-maturity investments	(221,680)	(148,991)	(94,954)
Proceeds from the sale of property and equipment	—	—	—

Redemptions of available-for-sale investments	450	400	987
Net cash used in investing activities from continuing operations	(6,397)	(36,516)	(15,950)
Financing activities			
Purchase and retirement of common stock	—	—	(3,756)
Principal payments of capital lease obligations	(288)	(390)	(472)
Excess tax benefit from stock-based compensation	—	—	39
Tax withholding payment related to net settlement of equity awards	(397)	(5)	(29)
Exercise of stock options	2,705	3,865	1,122
Net cash provided by (used in) financing activities from continuing operations	2,020	3,470	(3,096)
Discontinued operations			
Operating activities of discontinued operations	(1,227)	(2,505)	(5,496)
Investing activities of discontinued operations	(1,219)	(838)	(628)
Financing activities of discontinued operations	—	—	—
Net cash used in discontinued operations	(2,446)	(3,343)	(6,124)
Net increase (decrease) in cash and cash equivalents	63,613	(44,383)	(19,123)
Cash and cash equivalents at beginning of period	79,904	124,287	143,410
Cash and cash equivalents at end of period	$ 143,517	$ 79,904	$ 124,287
Supplemental disclosures of cash flow information			
Cash paid, net during the period for:			
Income taxes	$ 1,813	$ 1,804	$ 1,576
Non-cash activities			
Unrealized gain on investments, net of deferred tax expense of $25, $43, and $18, respectively	$ 70	$ 74	$ 27
Reclassification from share-based liability compensation to equity	$ 384	$ 307	$ 228
Forfeiture of vested stock-based compensation	$ —	$ —	$ 86
Acquisitions of property and equipment financed with capital lease obligation	$ —	$ —	$ 932
Change in foreign currency translation adjustments	$ 36	$ —	$ —
Acquisitions of property and equipment included in accounts payable	$ 379	$ 724	$ 1,045

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Significant Accounting Policies

Organization

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

Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of AeroVironment, Inc. and its wholly owned subsidiaries: AeroVironment Rhode Island, LLC, Skytower Inc., AeroVironment International PTE. LTD., AeroVironment, Inc. (Afghanistan), as well as the Company's Turkish joint venture, Altoy Savunma Sanayi ve Havacilik Anonim Sirketi ("Altoy") (collectively referred to herein as the "Company"). The Company increased its ownership in Altoy to a controlling interest on February 1, 2017. As a result of the increase in ownership, the consolidated financial statements include the balance sheet and results of operations of Altoy from February 1, 2017 forward. Prior to this date, the Company's investment in Altoy was accounted for under the equity method. Refer to Note 19 - Business Acquisitions for further details. All intercompany balances and transactions have been eliminated in consolidation.

In April 2016, the Company dissolved AV S.r.l. Italy, AILC, Inc. and AeroVironment Massachusetts, LLC the results of which were not material to the consolidated financial statements. In July 2016, the Company dissolved Charger Bicycles, LLC, the results of which were not material to the consolidated financial statements. In October 2016, the Company dissolved Skytower, LLC and Regenerative Fuel Cell Systems, LLC, the results of which were not material to the consolidated financial statements. In February 2018, the Company dissolved AeroVironment GmbH, the results of which were not material to the consolidated financial statements.

On June 1, 2018, the Company entered into an Asset Purchase Agreement (the “Purchase Agreement”) with Webasto Charging Systems, Inc. (“Webasto”) pursuant to which the Company agreed to sell, and Webasto agreed to acquire, substantially all of the assets of the Company’s EES business segment (the “EES Business”) and to assume certain liabilities related to the EES Business. As of April 30, 2018, we determined that the EES Business met the criterion for classification as an asset held for sale and represents a strategic shift in in our operations. Therefore, the assets and liabilities and the results of operations of the EES Business are reported in this Annual Report as discontinued operations for all periods presented.

Investments in Companies Accounted for Using the Equity or Cost Method

Investments in other non consolidated entities are accounted for using the equity method or cost basis depending upon the level of ownership and/or the Company’s ability to exercise significant influence over the operating and financial policies of the investee. When the equity method is used, investments are recorded at original cost and adjusted periodically to recognize the Company’s proportionate share of the investees’ net income or losses after the date of investment. When net losses from an investment accounted for under the equity method exceed its carrying amount, the investment balance is reduced to zero and additional losses are not provided for as the Company is not obligated to provide additional capital. The Company resumes accounting for the investment under the equity method if the entity subsequently reports net income and the Company’s share of that net income exceeds the share of net losses not recognized during the period the equity method was suspended.

When an investment accounted for using the equity method issues its own shares, the subsequent reduction in the Company’s proportionate interest in the investee is reflected in equity as an adjustment to paid in capital. The

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Company evaluates its investments in companies accounted for by the equity or cost method for impairment when there is evidence or indicators that a decrease in value may be other than temporary.

In December of 2017, the Company and Softbank Corp. ("Softbank") formed a joint venture, HAPSMobile, Inc. ("HAPSMobile"). As the Company has the ability to exercise significant influence over the operating and financial policies of HAPSMobile, the Company's investment is accounted as an equity method investment. The Company has presented its proportion of HAPSMobile's net loss in "Equity method investment activity, net of tax" in the consolidated statement of operations. The carrying value of the investment in HAPSMobile was recorded in "Other assets, long-term." Refer to Note 8 – Equity Method Investments for further details.

Segments

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker ("CODM") in deciding how to allocate resources and in assessing performance. The Company's CODM, who is the Chief Executive Officer, makes operating decisions, assesses performance and makes resource allocation decisions, including the focus of research and development ("R&D"), on a consolidated basis for the Company's continuing operations. Accordingly, the Company operates its business as a single reportable segment.

Use of Estimates

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

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. Equity method losses associated with the Company's investment in Altoy for the fiscal year ended 2017 and 2016 have been reclassified from other income (expense), net to equity method investment activity, net of tax on the consolidated statement of operations.

Cash Equivalents

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

Investments

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

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

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

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

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

Fair Values of Financial Instruments

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

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash, cash equivalents, municipal bonds, U.S. government securities, U.S. government-guaranteed agency securities, U.S. Government sponsored agency debt securities, highly rated commercial paper, highly rated corporate bonds, and accounts receivable. The Company currently invests the majority of its cash in municipal bonds, U.S. government securities, U.S. government-guaranteed agency securities, U.S. Government sponsored agency debt securities and highly rated corporate bonds. The Company’s revenue and accounts receivable are with a limited number of corporations and governmental entities. In the aggregate, 54%, 63% and 79% of the Company’s revenue came from agencies of the U.S. government for the years ended April 30, 2018, 2017 and 2016, respectively. These agencies accounted for 49% and 45% of the accounts receivable balances at April 30, 2018 and 2017, respectively. One such agency, the U.S. Army, accounted for 19%, 21% and 26% of the Company’s consolidated revenue for the years ended April 30, 2018, 2017 and 2016, respectively. The Company performs ongoing credit evaluations of its commercial customers and maintains an allowance for potential losses.

Accounts Receivable, Unbilled Receivables and Retentions

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

Retentions represent amounts withheld by customers until contract completion. At April 30, 2018 and 2017, the retention balances were $1,411,000 and $1,537,000, respectively. The Company determines the allowance for doubtful accounts based on historical customer experience and other currently available evidence. When a specific account is deemed uncollectible, the account is written off against the allowance. The allowance for doubtful accounts reflects the Company's best estimate of probable losses inherent in the accounts receivable balance; such losses have historically been within management's expectations. An account is deemed past due based on contractual terms rather than on how recently payments have been received.

Inventories

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

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Long Lived Assets

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

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

The Company finances the purchase of certain IT equipment and perpetual software licenses with capital lease arrangements. The assets and liabilities under capital leases are recorded at the lesser of the present value of aggregate future minimum lease payments, including estimated bargain purchase options, or the fair value of the asset under lease. Assets under capital leases are depreciated using the straight-line method over the lesser of the estimated useful life of the asset or the term of the lease.

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

The Company reviews the recoverability of its long lived assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The estimated future cash flows are based upon, among other things, assumptions about expected future operating performance, and may differ from actual cash flows. If the sum of the projected undiscounted cash flows (excluding interest) is less than the carrying value of the assets, the assets will be written down to the estimated fair value in the period in which the determination is made. There were no events or changes in circumstances that would indicate that the carrying amount of the assets may not be recoverable during the fiscal years ended April 30, 2018, 2017 and 2016.

Intangibles Assets — Acquired in Business Combinations

The Company performs valuations of assets acquired and liabilities assumed on each acquisition accounted for as a business combination and allocates the purchase price of the acquired business to the respective net tangible and intangible assets. Acquired intangible assets include customer relationships and trade names. The Company determines the appropriate useful life by performing an analysis of expected cash flows based on historical experience of the acquired businesses. Intangible assets are amortized over their estimated useful lives using the straight-line method which approximates the pattern in which the economic benefits are consumed.

The Company monitors conditions related to these assets to determine whether events and circumstances warrant a revision to the remaining amortization period. The Company tests its intangible assets with finite lives for potential impairment whenever management concludes events or changes in circumstances indicate that the carrying amount may not be recoverable. The original estimate of an asset's useful life and the impact of an event or circumstance on either an asset's useful life or carrying value involve significant judgment.

Product Warranty

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

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Accrued Sales Commissions

As of April 30, 2018 and 2017, the Company accrued sales commissions in other current liabilities of $1,293,000 and $4,555,000, respectively.

Self Insurance Liability

The Company is self-insured for employee medical claims, subject to individual and aggregate stop loss policies. The Company estimates a liability for claims filed and incurred but not reported based upon recent claims experience and an analysis of the average period of time between the occurrence of a claim and the time it is reported to and paid by the Company. As of April 30, 2018 and 2017, the Company estimated and recorded a self-insurance liability in wages and related accruals of approximately $1,003,000 and $1,133,000, respectively.

Income Taxes

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and income tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. The provision for income taxes reflects the taxes to be paid for the period and the change during the period in the deferred income tax assets and liabilities. The Company records a valuation allowance to reduce the deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. For uncertain tax positions, the Company determines whether it is “more likely than not” that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. For those tax positions where it is “not more likely than not” that a tax benefit will be sustained, no tax benefit is recognized. Where applicable, associated interest and penalties are also recorded.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, repeal of the corporate alternative minimum tax, repeal of the deduction for domestic production activities, and limitation on the deductibility of certain executive compensation.

In accordance with U.S. GAAP as determined by ASC 740, Income Taxes, the Company is required to record the effects of tax law changes in the period enacted. As the Company has an April 30 fiscal year end, its U.S. federal corporate income tax rate will be blended in fiscal 2018, resulting in a statutory federal rate of approximately 30.4% (eight months at 35% and four months at 21%), and will be 21% for subsequent fiscal years. The Company remeasured its existing deferred tax assets and liabilities at the rate the Company expects to be in effect when those deferred taxes will be realized (30.4% if in 2018 or 21% thereafter) and recorded a one-time deferred tax expense of approximately $3,400,000 during the year ended April 30, 2018.

The Company followed the guidance in SEC Staff Accounting Bulletin 118 (“SAB 118”), which provides additional clarification regarding the application of ASC Topic 740 in situations where the Company does not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Tax Act for the reporting period in which the Act was enacted. SAB 118 provides for a measurement period beginning in the reporting period that includes the Act’s enactment date and ending when the Company has obtained, prepared, and analyzed the information needed in order to complete the accounting requirements but in no circumstances should the measurement period extend beyond one year from the enactment date.

The $3,400,000 expense for the one-time deferred tax remeasurement is a provisional estimate of the impact of the Tax Act. In addition, the Company has estimated that it will not have an income tax payable as a result of the one-time deemed repatriation transition tax on unrepatriated foreign earnings. These amounts are considered provisional because they use estimates for which final tax computations or returns have not been completed and because estimated amounts may be impacted by future regulatory and accounting guidance if and when issued.

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The Company's financial statements do not reflect the impact of certain aspects of the Tax Act as the Company did not have the necessary information available, prepared, or analyzed (including computations), or because sufficient guidance has not been issued in order to determine an actual or provisional amount for the tax effects of the Act. To date, these aspects include the new compensation related provisions under section 162(m) and the state income tax conformity to the Tax Act.

Customer Advances and Amounts in Excess of Cost Incurred

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

Revenue Recognition

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

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

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

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

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

Revenue and profits on fixed price production contracts, where units are produced and delivered in a continuous or sequential process, are recorded as units are delivered based on their selling prices (the "units of delivery method"). Revenue and profits on other fixed price contracts with significant engineering as well as production requirements are recorded based on the ratio of total actual incurred costs to date to the total estimated costs for each contract (the "cost to cost method"). Accounting for revenue and profits on a fixed price contract requires the preparation of estimates of (1) the total contract revenue, (2) the total costs at completion, which is equal to the sum of the actual incurred costs to date on the contract and the estimated costs to complete the contract's statement of work and (3) the measurement of progress towards completion. The estimated profit or loss at completion on a contract is equal to the difference between the total estimated contract revenue and the total estimated cost at completion. Under the units of delivery method, sales on a fixed price type contract are recorded as the units are delivered during the period based on their contractual selling prices. Under the cost to cost method, sales on a fixed price type contract are recorded at amounts equal to the ratio of

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actual cumulative costs incurred divided by total estimated costs at completion, multiplied by (i) the total estimated contract revenue, less (ii) the cumulative sales recognized in prior periods. The profit recorded on a contract in any period using either the units of delivery method or cost to cost method is equal to (i) the current estimated total profit margin multiplied by the cumulative sales recognized, less (ii) the amount of cumulative profit previously recorded for the contract. In the case of a contract for which the total estimated costs exceed the total estimated revenue, a loss arises, and a provision for the entire loss is recorded in the period that it becomes evident. The unrecoverable costs on a loss contract that are expected to be incurred in future periods are recorded in the program cost.

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management's estimates change on the basis of development of the business, market conditions or other factors. Management judgments and estimates have been applied consistently and have been reliable historically. The Company believes that there are two key factors which impact the reliability of management's estimates. The first of those key factors is that the terms of the Company's contracts are typically less than six months. The short term nature of such contracts reduces the risk that material changes in accounting estimates will occur on the basis of market conditions or other factors. The second key factor is that the Company has hundreds of contracts in any given accounting period, which reduces the risk that any one change in an accounting estimate on one or several contracts would have a material impact on the Company's consolidated financial statements or its two reporting segments' measures of profit. Changes in estimates are recognized using the cumulative catch up method of accounting. This method recognizes, in the current period, the cumulative effect of the changes on current and prior periods.

Stock Based Compensation

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

Long Term Incentive Awards

For long term incentive awards outstanding as of April 30, 2018, the awards include time-based awards which vest equally over three years and performance-based awards which vest based on the achievement of a target payout established at the beginning of each performance period. The actual payout at the end of the performance period is calculated based upon the Company's achievement of such targets. Payouts are made in cash and restricted stock units. Upon vesting of the restricted stock units, the Company has the discretion, but not an obligation, to settle the restricted stock units in cash or stock.

The cash component of the award is accounted for as a liability. The equity component is accounted for as a stock based liability, as the restricted stock units may be settled in cash or stock. At each reporting period, the Company reassesses the probability of achieving the performance targets. The estimation of whether the performance targets will be achieved requires judgment, and, to the extent actual results or updated estimates differ from the Company's current estimates, the cumulative effect on current and prior periods of those changes will be recorded in the period estimates are revised.

Research and Development

Internally funded research and development costs ("IRAD"), sponsored by the Company relate to both U.S. government products and services and those for commercial and foreign customers. IRAD costs for the Company are recoverable and allocable under government contracts in accordance with U.S. government procurement regulations.

Customer funded research and development costs are incurred pursuant to contracts (revenue arrangements) to perform research and development activities according to customer specifications. These costs are direct contract costs and are expensed to cost of sales when the corresponding revenue is recognized, which is generally as the research and development services are performed. Revenue from customer funded research and development was approximately

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$51,848,000, $43,615,000 and $53,546,000 for the years ended April 30, 2018, 2017 and 2016, respectively. The related cost of sales for customer funded research and development totaled approximately $36,415,000, $29,790,000 and $34,786,000 for the years ended April 30, 2018, 2017 and 2016, respectively.

In January 2017, the Company executed a cost sharing Other Transaction Agreement type contract funded by the US Federal Government to perform certain system design, development and functional testing activities specific to a new prototype UAS on a best-efforts basis. The total estimated costs of the project are approximately $14,200,000, of which the Company is responsible for funding $6,100,000. The remaining $8,100,000 will be reimbursed to the Company as the activities are performed. The term of the agreement is through October 2018. The Company has determined that the contract meets the criteria of ASC 912-730-05 Contractors – Federal Government and, therefore, all reimbursements are recorded as an offset to research and development expense in the consolidated statements of operations. Reimbursements under the contract were $4,188,000 and $233,000 for the fiscal years ended April 30, 2018 and 2017, respectively.

Lease Accounting

The Company accounts for its leases and subsequent amendments as operating leases or capital leases for financial reporting purposes. Certain operating leases contain rent escalation clauses, which are recorded on a straight line basis over the initial term of the lease with the difference between the rent paid and the straight line rent recorded as a deferred rent liability. Lease incentives received from landlords are recorded as deferred rent liabilities and are amortized on a straight line basis over the lease term as a reduction to rent expense. Deferred rent liabilities were approximately $1,536,000 and $1,719,000 as of April 30, 2018 and 2017, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses included in SG&A expenses were approximately $526,000, $227,000 and $232,000 for the years ended April 30, 2018, 2017 and 2016, respectively.

Foreign Currency Transactions

Foreign currency transaction gains and losses are charged or credited to earnings as incurred. For the fiscal years ended April 30, 2018, 2017 and 2016, foreign currency transaction gains and losses that are included in other income (expense) in the accompanying statements of operations were $87,000, $(284,000), and $(63,000), respectively.

Earnings Per Share

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

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The reconciliation of diluted to basic shares is as follows:

	Year Ended April 30, 2018	2017	2016
Numerator for basic and diluted earnings (loss) per share:			
Continuing operations attributable to AeroVironment	$ 22,576,000	$ 16,633,000	$ 15,393,000
Discontinued operations, net of tax	(2,508,000)	(4,154,000)	(6,427,000)
Net income attributable to AeroVironment	$ 20,068,000	$ 12,479,000	$ 8,966,000
Denominator for basic earnings per share:			
Weighted average common shares	23,471,241	23,059,045	22,936,413
Dilutive effect of employee stock options, restricted stock and restricted stock units	342,531	248,693	217,080
Denominator for diluted earnings per share	23,813,772	23,307,738	23,153,493

During the years ended April 30, 2018, 2017 and 2016, certain options, shares of restricted stock and restricted stock units were not included in the computation of diluted earnings per share because their inclusion would have been anti dilutive. The number of options, restricted stock and restricted stock units which met this anti dilutive criterion was approximately 22,000, 86,000 and 22,000 for the years ended April 30, 2018, 2017 and 2016, respectively.

Recently Adopted Accounting Standards

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This ASU does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. This ASU eliminates from U.S. GAAP the requirement to measure inventory at the lower of cost or market. Market under the previous requirement could be replacement cost, net realizable value, or net realizable value less a normal profit margin. Entities within the scope of this update will now be required to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory using LIFO or the retail inventory method. The Company's adoption of ASU 2015-11 effective May 1, 2017 did not have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the test for goodwill impairment by removing Step 2 from the goodwill impairment test. If goodwill impairment is realized, the amount recognized will be the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized cannot exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 must be applied on a prospective basis and will become effective for public entities in the first quarter of the year ending July 31, 2020, with early adoption available. The Company elected to early adopt the standard during the three months ended October 28, 2017. The Company's adoption of ASU 2017-04 did not have a material impact on its consolidated financial statements.

Recently Issued Accounting Standards

In January 2017, the FASB issued ASU 2017-01, Business Combinations – Clarifying the definition of a business (Topic 805). This ASU clarifies the definition of a business with the objective of providing a more robust framework to evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance will be effective for fiscal years beginning after December 15, 2017, including interim periods within that fiscal year, with early adoption permitted. The amendments are to be applied prospectively to business combinations that occur after the effective date.

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In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments (Topic 230). This ASU adds and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2017 and interim periods therein, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This ASU requires the lessee to recognize the effective for fiscal years beginning after December 15, 2018 and interim periods therein, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its consolidated financial statements. The Company currently does not hold a large number of leases that are classified as operating leases under the existing lease standard, with the only significant leases being the Company's various property leases. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new standard was originally effective for reporting periods beginning after December 15, 2016 and early adoption was not permitted. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606)-Deferral of the Effective Date. This update approved a one-year delay of the effective date to reporting periods beginning after December 15, 2017, while permitting companies to voluntarily adopt the new standard as of the original effective date. Since the issuance of ASU 2014- 09, the FASB has issued several amendments to provide additional supplemental guidance on certain aspects of the original pronouncement. The core principle of ASU 2014-09 is to recognize revenue upon the transfer of goods or services to customers at an amount that reflects the consideration expected to be received. In adopting the guidance, companies are permitted to select between two transition methods: (1) a full retrospective transition method with the application of the new guidance to each prior reporting period presented, or (2) a retrospective transition method that recognizes the cumulative effect on prior periods at the date of adoption together with additional footnote disclosures.

Contracts for product deliveries of the Company's tactical missile systems that have historically recognized revenue as the related products were delivered will recognize revenue under the new standard over time as costs are incurred. In addition, services performed under contracts for both the Company's tactical missile systems and small UAS that have historically recognized revenue upon customer acceptance will recognize revenue under the new standard over time using an appropriate measure of progress, which is generally as costs are incurred. The new standard will not change the total amount of revenue recognized on these contracts, it will only accelerate the timing of when the revenue is recognized, resulting in an increase to unbilled receivables. The timing of cost of sales recognition for these contracts will also be accelerated, resulting in a decrease in inventories.

The new standard will not have a significant impact to revenue recognition for product deliveries of the Company's small UAS family of systems that have historically recognized revenue as the related products were delivered. Under the new standard the Company will recognize revenue for these contracts at a point in time when the products transfer to the customer.

The new standard will not have a significant impact to revenue recognition for the Company's customer-funded research and development contracts that we have historically recognized revenue based on percentage of completion. Under the new standard the Company will recognize revenue for these contracts over time as costs are incurred which approximates percentage of completion.

The Company is adopting ASU 2014-09 in the first quarter of 2019 using the full retrospective transition method which will require its fiscal year 2016 and 2017 financial statements to be revised. As described above, certain contracts under the new standard will recognize revenue as costs are incurred (or other appropriate measure of progress as applicable) as compared to as units are delivered under ASC 605 – Revenue Recognition, which will result in an increase in revenue from continuing operations of approximately $4.2 million in fiscal year 2017. The revision will also result in a cumulative adjustment from continued operations to increase retained earnings by approximately $0.7 million and $1.8 million for the fiscal years ended April 30, 2016 and 2017, respectively.

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The majority of the Company's contracts in its discontinued EES business are product purchase order, bill and ship arrangements that have historically recognized revenue as the related products were delivered. The Company does not anticipate a significant impact to revenue recognition under the new standard.

Due to the significant amount of revenues that occurred during the fourth quarter of fiscal 2018, the Company is continuing to assess the impact of adopting the new standard to its fiscal 2018 financial statements.

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2. Discontinued Operations

On June 1, 2018, the Company entered into the Purchase Agreement with Webasto pursuant to which the Company agreed to sell, and Webasto agreed to acquire, substantially all of the assets of the EES Business and to assume certain liabilities related to the EES Business. The Company anticipates that the transaction will close within its first quarter of fiscal 2019. As of April 30, 2018, the Company determined that the EES Business met the criterion for classification as an asset held for sale and represents a strategic shift in in our operations. Therefore, the assets and liabilities and the results of operations of the EES Business are reported as discontinued operations for all periods presented. The table below presents the statements of operations data for the EES Business.

	Year Ended April 30,		
	2018	2017	2016
Net sales	$ 37,899	$ 35,933	$ 30,360
Cost of sales	30,890	29,008	23,831
Gross margin:	7,009	6,925	6,529
Selling, general and administrative	7,825	8,895	9,614
Research and development	3,526	4,577	7,251
Other (expense) income, net	(27)	7	28
Loss from discontinued operations before income taxes	(4,369)	(6,540)	(10,308)
Benefit for income taxes	(1,861)	(2,386)	(3,881)
Net loss from discontinued operations	$ (2,508)	$ (4,154)	$ (6,427)

The major classes of assets and liabilities included in discontinued operations related to the EES Business are presented in the table below.

	April 30,	
	2018	2017
Carrying amount of assets classified as discontinued operations		
Current assets:		
Accounts receivable, net of allowance for doubtful accounts of $139 at April 30, 2018 and $187 at April 30, 2017	$ 6,348	$ 5,642
Inventories, net	18,716	19,168
Prepaid expenses and other current assets	185	120
Property and equipment, net	3,100	—
Total current assets classified as discontinued operations	28,349	24,930
Property and equipment, net	—	3,258
Total non-current assets classified as discontinued operations	—	3,258
Total assets classified as discontinued operations	$ 28,349	$ 28,188
Carrying amount of liabilities classified as discontinued operations		
Current liabilities:		

Accounts payable	$ 5,121	$ 4,388
Wages and related accruals	1,946	2,019
Customer advances	918	1,260
Other current liabilities	1,199	1,634
Total current liabilities	9,184	9,301
Total liabilities classified as discontinued operations	$ 9,184	$ 9,301

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3. Investments

Investments consist of the following:

	April 30, 2018 (In thousands)	2017
Short-term investments:		
Held-to-maturity securities:		
Municipal securities	$ 35,344	$ 47,437
U.S. government securities	31,620	14,515
Corporate bonds	46,685	55,519
Certificates of deposit	—	2,500
Total held-to-maturity and short-term investments	$ 113,649	$ 119,971
Long-term investments:		
Held-to-maturity securities:		
Municipal securities	$ 2,046	$ 8,942
U.S. government securities	27,356	22,540
Corporate bonds	9,112	8,117
Total held-to-maturity investments	38,514	39,599
Available-for-sale securities:		
Auction rate securities	2,142	2,497
Total available-for-sale investments	2,142	2,497
Total long-term investments	$ 40,656	$ 42,096

Held To Maturity Securities

As of April 30, 2018 and 2017, the balance of held to maturity securities consisted of state and local government municipal securities, U.S. government securities, corporate bonds and certificates of deposit. Interest earned from these investments is recorded in interest income.

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

	April 30, 2018				April 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal securities	$ 37,390	$ 9	$ (36)	$ 37,363	$ 56,379	$ 30	$ (21)	$ 56,388
U.S. government securities	58,976	—	(367)	58,609	37,055	2	(41)	37,016
Corporate bonds	55,797	2	(71)	55,728	63,636	9	(85)	63,560
Certificates of deposit	—	—	—	—	2,500	1	—	2,501
Total held-to-maturity investments	$ 152,163	$ 11	$ (474)	$ 151,700	$ 159,570	$ 42	$ (147)	$ 159,465

The amortized cost and fair value of the Company's held to maturity securities by contractual maturity at April 30, 2018, are as follows:

	Cost	Fair Value
Due within one year	$ 113,649	$ 113,443
Due after one year through five years	38,514	38,257
Total	$ 152,163	$ 151,700

Available For Sale Securities

Auction Rate Securities

As of April 30, 2018 and 2017, the entire balance of available for sale auction rate securities consisted of two investment grade auction rate municipal bonds with maturities ranging from 1 to 16 years. These investments have characteristics similar to short term investments, because at pre determined intervals, generally ranging from 30 to 35 days, there is a new auction process at which the interest rates for these securities are reset to current interest rates. At the end of such period, the Company chooses to roll over its holdings or redeem the investments for cash. A market maker facilitates the redemption of the securities and the underlying issuers are not required to redeem the investment within 365 days. Interest earned from these investments is recorded in interest income.

During the fourth quarter of the fiscal year ended April 30, 2008, the Company began experiencing failed auctions on some of its auction rate securities. A failed auction occurs when a buyer for the securities cannot be obtained and the market maker does not buy the security for its own account. The Company continues to earn interest on the investments that failed to settle at auction, at the maximum contractual rate until the next auction occurs. In the event the Company needs to access funds invested in these auction rate securities, the Company may not be able to liquidate these securities at the fair value recorded on April 30, 2018 until a future auction of these securities is successful or a buyer is found outside of the auction process.

As a result of the failed auctions, the fair values of these securities are estimated utilizing a discounted cash flow analysis as of April 30, 2018 and 2017. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction.

Based on the Company's ability to access its cash and cash equivalents, expected operating cash flows, and other sources of cash, the Company does not anticipate the current lack of liquidity on these investments will affect its ability to operate the business in the ordinary course. The Company believes the current lack of liquidity of these investments is temporary and expects that the securities will be redeemed or refinanced at some point in the future. The

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Company will continue to monitor the value of its auction rate securities at each reporting period for a possible impairment if a further decline in fair value occurs. The auction rate securities have been in an unrealized loss position for more than 12 months. The Company has the ability and the intent to hold these investments until a recovery of fair value, which may be maturity and as of April 30, 2018, it did not consider these investments to be other than temporarily impaired.

The amortized cost, gross unrealized losses, and estimated fair value of the available for sale auction rate securities are as follows (in thousands):

	April 30, 2018	2017
Auction rate securities		
Amortized cost	$ 2,250	$ 2,700
Gross unrealized losses	(108)	(203)
Fair value	$ 2,142	$ 2,497

The amortized cost and fair value of the Company's auction rate securities by contractual maturity at April 30, 2018 are as follows (in thousands):

	Cost	Fair Value
Due after one through five years	$ 250	$ 252
Due after 10 years	2,000	1,890
Total	$ 2,250	$ 2,142

Equity Securities

At April 30, 2015, the entire balance of available-for-sale equity securities consisted of 618,042 CybAero AB ("CybAero") common shares. The shares were classified as available-for-sale. These shares were initially acquired on August 11, 2014, when the Company converted a convertible bond into CybAero common shares. The convertible bond was in the amount of 10 million SEK and was converted into 1,062,699 common shares of CybAero at the conversion price of 9.41 SEK per share. When the Company converted the bond on August 11, 2014, the fair value per share was 37.50 SEK which became the new cost basis going forward, with all subsequent changes in fair value being recorded to other comprehensive income.

At August 1, 2015, the Company reviewed these shares for impairment based on criteria that included the extent to which the investment's carrying value exceeds its related market value, the duration of the market decline, uncertainty as to the recovery period due to sustained losses of the investee and the Company's intent to hold its investment until recovery. In the three months ended August 1, 2015, the Company determined it was in its best interests to liquidate the remaining shares held. As a result, during the three months ended August 1, 2015, the Company recorded an other-than-temporary-impairment loss of $2,186,000 related to the Company's investment in the CybAero shares which was recorded to other (expense), net in the consolidated statement of operations. As a result of recording the impairment charge, the investment's fair value became its new cost basis.

In August 2015, the Company sold its remaining shares in CybAero in a private sale at the price of 12.00 SEK per share, resulting in proceeds of approximately $777,000. During the fiscal year ended April 30, 2016, the Company realized gains on the sale of CybAero shares of $207,000, based on the difference between the original conversion price of 9.41 SEK per share and the sales price at the time of sale, inclusive of the final sale of all shares.

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4. Fair Value Measurements

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

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

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

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

The Company's financial assets measured at fair value on a recurring basis at April 30, 2018, 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	$ —	$ —	$ 2,142	$ 2,142
Total	$ —	$ —	$ 2,142	$ 2,142

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)

Balance at May 1, 2017	$	2,497
Transfers to Level 3		—
Total gains (realized or unrealized)		
Included in earnings		—
Included in other comprehensive income		95
Purchases, issuances and settlements, net		(450)
Balance at April 30, 2018	$	2,142
The amount of total gains or (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at April 30, 2018	$	—

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. As of April 30, 2018, the inputs used in the Company's discounted cash flow analysis included current coupon rates of 2.8%, estimated redemption periods of 1 to 16 years and discount rates of 3.6% to 9.8%. The discount rates were based

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on market rates for municipal bond securities, as adjusted for a risk premium to reflect the lack of liquidity of these investments.

5. Inventories, net

Inventories consist of the following:

	April 30, 2018	2017
	(In thousands)	
Raw materials	$ 12,020	$ 12,664
Work in process	15,995	14,618
Finished goods	14,578	16,382
Inventories, gross	42,593	43,664
Reserve for inventory excess and obsolescence	(3,953)	(2,756)
Inventories, net	$ 38,640	$ 40,908

6. Intangibles

Intangibles are included in other assets on the balance sheet. The components of intangibles are as follows:

	April 30, 2017	Impairment Charges	April 30, 2018
	(In thousands)		
Licenses	$ 818	$ -	$ 818
Customer relationships	1,600	(867)	733
Trademarks and tradenames	60	(32)	28
Other	3	-	3
Intangibles, gross	2,481	$ (899)	1,582
Less accumulated amortization	(658)		(954)
Intangibles, net	$ 1,823		$ 628

The Company tests identifiable intangible assets and goodwill for impairment in the fourth quarter of each fiscal year unless there are interim indicators that suggest that it is more likely than not that either the identifiable intangible assets or goodwill may be impaired. Due to the current political situation within Turkey and the increased uncertainty in the relations between the U.S. and Turkey, the Company significantly lowered its cash flow expectations for its Altoy operations. As a result of the decline in the Company's cash flow forecast, the Company performed an interim assessment of impairment of Altoy's long-lived assets, excluding goodwill during the three months ended October 28, 2017. Based on the analysis, the Company determined that the fair value of Altoy had declined below its carrying value, excluding goodwill. As a result, the Company performed an additional analysis to determine the amount of the impairment loss and recorded an impairment loss totaling $899,000, which is included in selling, general and administrative expense on the consolidated statements of operations. The fair value of the Altoy asset group was determined based on a discounted cash flow model reflective of the revised cash flow estimates.

The weighted average amortization period at April 30, 2018 and 2017 was three years and six years, respectively. Amortization expense for the years ended April 30, 2018, 2017 and 2016 was $296,000, $139,000 and $80,000, respectively.

The customer relationships, trademarks and tradenames, and other intangible assets were recognized in conjunction with the Company's acquisition of a controlling interest in its Altoy joint venture on February 1, 2017. Refer to Note 19 - Business Combinations for further details.

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Estimated amortization expense for the next five years is as follows:

	Year ending April 30, (In thousands)
2019	$ 275
2020	255
2021	98
2022	—
2023	—
	$ 628

7. Property and Equipment, net

Property and equipment, net consist of the following:

	April 30, 2018 (In thousands)	2017
Leasehold improvements	$ 10,541	$ 9,506
Machinery and equipment	40,377	37,287
Furniture and fixtures	2,094	1,857
Computer equipment and software	31,895	26,682
Construction in process	3,359	4,467
Property and equipment, gross	88,266	79,799
Less accumulated depreciation and amortization	(69,047)	(63,837)
Property and equipment, net	$ 19,219	$ 15,962

Depreciation expense for the years ended April 30, 2018, 2017 and 2016 was $5,676,000, $4,939,000 and $3,799,000, respectively. At April 30, 2018 and 2017, property and equipment includes computer equipment and software under capital leases with a cost basis of $1,836,000 and $1,836,000 and accumulated depreciation of $1,687,000 and $1,433,000, respectively. Depreciation of computer equipment and software under capital leases was $201,000 and $375,000 for the fiscal years ended April 30, 2018 and 2017 respectively.

8. Investments in Companies Accounted for Using the Equity Method

In December of 2017, the Company and Softbank formed a joint venture, HAPSMobile. HAPSMobile is a Japanese corporation that is 5% owned by the Company and 95% owned by SoftBank and is governed by a Joint Venture Agreement (the “JVA”). The Company purchased its 5% stake in HAPSMobile for 210,000,000 yen ($1,860,000) effective as of December 27, 2017 and 150,000,000 yen ($1,407,000) on April 17, 2018. Under the JVA, the Company committed to make an additional capital contribution of 209,500,000 yen (approximately $1,900,000) in or around January 2019 to maintain its 5% ownership stake. Additionally under the JVA, the Company may purchase additional shares of HAPSMobile, at the same per share price for the purchase of its original 5% stake, to increase its ownership percentage of HAPSMobile up to 19% prior to the first flight test of the prototype aircraft produced under a design and development agreement between HAPSMobile and the Company.

As the Company has the ability to exercise significant influence over the operating and financial policies of HAPSMobile, the Company’s investment is accounted as an equity method investment. At April 30, 2018, the Company recorded 5% of the net loss of HAPSMobile, or $1,283,000, in “Equity method investment activity, net of tax” in the consolidated statements of income. At April 30, 2018, the carrying value of the investment in HAPSMobile was $2,020,000 and was recorded in “Other assets, long-term.”

In March of 2014, the Company purchased 49% of the outstanding common stock of Altoy, a Turkish corporation founded in February 2014. During the years ended April 30, 2017 and 2016, the Company recorded 49% of the net loss of Altoy, or $119,000 and $138,000, respectively, in “Equity method investment activity, net of tax” in the consolidated statements of income. At April 30, 2016, the carrying value of the investment in Altoy was $386,000 and was recorded in “Other assets, long term.”

On February 1, 2017, the Company acquired an additional 36% interest in Altoy, increasing the Company’s total ownership interest to 85%, for total cash consideration of $625,000. As a result of the Company obtaining a controlling interest in Altoy, Altoy has been consolidated into the consolidated financial statements of the Company as of the date of the acquisition. Refer to Note 19 - Business Acquisitions.

9. Warranty Reserves

Warranty reserve activity is summarized as follows:

	April 30,	
	2018	2017
	(In thousands)	
Beginning balance	$ 1,947	$ 3,094
Warranty expense	1,884	187
Changes in estimates related to pre-existing warranties	—	1,651
Warranty costs settled	(1,741)	(2,985)
Ending balance	$ 2,090	$ 1,947

During the fiscal year ended April 30, 2017, the Company revised its estimates based on the results of additional engineering studies and recorded incremental warranty reserve charges totaling $1,651,000 related to the estimated costs to repair a component of certain small UAS that were delivered in prior periods. At April 30, 2018 and 2017, there were zero and $441,000 remaining estimated warranty costs related to the repair of the impacted small UAS, respectively. As of April 30, 2018 and 2017, a total of $2,198,000 and $1,762,000 of costs related to this warranty have been incurred, respectively.

10. Employee Savings Plan

The Company has an employee 401(k) savings plan covering all eligible employees. The Company expensed approximately $2,953,000, $2,603,000 and $2,546,000 in contributions to the plan for the years ended April 30, 2018, 2017 and 2016, respectively.

11. Severance Charges

During the fiscal year ended April 30, 2017, the Company recorded severance costs totaling $1,262,000. Of this total, approximately $850,000 was due to two officers who left the Company during the fiscal year ended April 30, 2017. The remaining severance costs were due to certain strategic headcount reductions consisting entirely of severance payments. Of the total, approximately $555,000 was recorded to cost of sales and $707,000 was recorded to SG&A. Of the total, approximately $127,000 was in accrued wages and related accruals at April 30, 2017.

During the fiscal year ended April 30, 2016, the Company made certain strategic headcount reductions with a total cost of approximately $702,000, consisting entirely of severance payments. The Company recorded this charge during its fourth fiscal quarter ended April 30, 2016. Of the total, approximately $300,000 was recorded to cost of sales and $402,000 was recorded to SG&A. Of the total, approximately $642,000 was in accrued wages and related accruals at April 30, 2016. All amounts were paid out prior to April 30, 2017.

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12. Stock Based Compensation

For the years ended April 30, 2018, 2017 and 2016, the Company recorded stock based compensation expense of approximately $4,956,000, $3,392,000 and $4,002,000, respectively.

On January 14, 2007, the stockholders of the Company approved the 2006 Equity Incentive Plan, or 2006 Plan, effective January 21, 2007, for officers, directors, key employees and consultants. On September 29, 2011, the stockholders of the Company approved an amendment and restatement of the 2006 Plan, or Restated 2006 Plan. Under the Restated 2006 Plan, incentive stock options, nonqualified stock options, restricted stock awards, stock appreciation right awards, performance share awards, performance stock unit awards, dividend equivalents awards, stock payment awards, deferred stock awards, restricted stock unit awards, other stock based awards, performance bonus awards or performance based awards may be granted at the discretion of the compensation committee, which consists of outside directors. A maximum of 4,884,157 shares of stock may be issued pursuant to awards under the Restated 2006 Plan. The maximum number of shares of common stock with respect to one or more awards that may be granted to any one participant during any twelve month period is 2,000,000. A maximum of $5,000,000 may be paid in cash to any one participant as a performance based award during any twelve month period. The exercise price for any incentive stock option shall not be less than 100% of the fair market value on the date of grant. Vesting of awards is established at the time of grant.

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

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

The fair value of stock options granted was estimated at the grant date using the Black Scholes option pricing model with the following weighted average assumptions for the years ended April 30, 2018, 2017 and 2016:

	Year Ended April 30,		
	2018	2017	2016
Expected term (in years)	—	—	6.00
Expected volatility	—%	—%	36.14 %
Risk-free interest rate	—%	—%	1.88 %
Expected dividend	—	—	—
Weighted average fair value at grant date	$ —	$ —	$ 10.18

No options were granted during the fiscal years ended April 30, 2018 and 2017.

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

The expected volatility is based on historical volatility for the Company's stock.

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

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

Information related to the stock option plans at April 30, 2018, 2017 and 2016, and for the years then ended is as follows:

	Restated 2006 Plan		2002 Plan		1992 Plan	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at April 30, 2015	652,117	23.96	44,993	7.57	78,604	0.59
Options granted	128,000	26.83	—	—	—	—
Options exercised	(43,000)	21.81	(31,161)	5.70	(10,000)	0.59
Options canceled	(58,318)	25.98	(8)	2.13	—	—
Outstanding at April 30, 2016	678,799	24.46	13,824	11.79	68,604	0.59
Options granted	—	—	—	—	—	—
Options exercised	(167,310)	22.32	(9,601)	11.79	(25,189)	0.59
Options canceled	(64,865)	26.76	(4,223)	11.79	—	—
Outstanding at April 30, 2017	446,624	24.93	—	—	43,415	0.59
Options granted	—	—	—	—	—	—
Options exercised	(107,598)	23.80	—	—	(25,113)	0.59
Options canceled	—	—	—	—	—	—
Outstanding at April 30, 2018	339,026	25.29	—	—	18,302	0.59
Options exercisable at April 30, 2018	256,012	$ 24.81	—	$ —	18,302	$ 0.59

The total intrinsic value of all options exercised during the years ended April 30, 2018, 2017 and 2016 was approximately $2,407,000, $1,747,000, and $1,198,000, respectively. The intrinsic value of all options outstanding at April 30, 2018 and 2017 was $10,890,000 and $2,840,000, respectively. The intrinsic value of all exercisable options at April 30, 2018 and 2017 was $8,587,000 and $2,454,000, respectively.

A summary of the status of the Company's non vested stock options as of April 30, 2018 and the year then ended is as follows:

Non-vested Options	Options	Weighted Average Grant Date Fair Value
Non-vested at April 30, 2017	140,118	$ 10.76
Granted	—	—
Expired	—	—
Canceled	—	—
Vested	(57,104)	10.45
Non-vested at April 30, 2018	83,014	$ 10.97

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As of April 30, 2018, there was approximately $7,045,000 of total unrecognized compensation cost related to non vested share based compensation awards granted under the equity plans. That cost is expected to be recognized over an approximately two year period or a weighted average period of approximately 1.9 years.

The weighted average fair value of options issued for the year ended April 30, 2016 was $10.18. No options were granted during the fiscal years ended April 30, 2018 and 2017. The total fair value of shares vesting during the years ended April 30, 2018, 2017 and 2016 was $3,328,000, $2,942,000 and $2,495,000, respectively.

Proceeds from all option exercises under all stock option plans for the years ended April 30, 2018, 2017 and 2016 were approximately $2,576,000, $3,863,000 and $1,121,000, respectively. The tax benefit realized from stock based compensation during the years ended April 30, 2018, 2017 and 2016 was approximately $0, $0, and $98,000, respectively.

The following tabulation summarizes certain information concerning outstanding and exercisable options at April 30, 2018:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	As of April 30, 2018	Weighted Average Remaining Contractual Life In Years	Weighted Average Exercise Price	As of April 30, 2018	Weighted Average Exercise Price
$ 0.59 - 19.16	72,302	4.23	$ 13.78	72,302	$ 13.78
19.17 - 26.24	58,500	4.86	20.54	48,500	20.71
26.25 - 26.99	80,000	7.15	26.70	32,000	26.70
27.00 - 27.99	50,000	5.56	27.27	40,000	27.27
28.00 - 32.19	96,526	4.59	29.90	81,512	29.65
$ 0.59 - 32.19	357,328	5.27	$ 24.02	274,314	$ 23.20

The remaining weighted average contractual life of exercisable options at April 30, 2018 was 4.88 years.

Information related to the Company's restricted stock awards at April 30, 2018 and for the year then ended is as follows:

	Restated 2006 Plan	
	Shares	Weighted Average Grant Date Fair Value
Unvested stock at April 30, 2017	339,145	$ 26.27
Stock granted	131,332	37.71
Stock vested	(133,886)	25.25
Stock canceled	(4,016)	26.10
Unvested stock at April 30, 2018	332,575	$ 31.20

13. Long Term Incentive Awards

During the three months ended July 29, 2017, the Company granted awards under its amended and restated 2006 Equity Incentive Plan (the "Restated 2006 Plan") to key employees ("Fiscal 2018 LTIP"). Awards under the Fiscal 2018 LTIP consist of: (i) time-based restricted stock awards which vest in equal tranches in July 2018, July 2019 and

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July 2020, and (ii) performance-based restricted stock units ("PRSUs") which vest based on the Company's achievement of revenue and operating income targets for the three-year period ending April 30, 2020. At the award date, target achievement levels for each of the financial performance metrics were established for the PRSUs, at which levels the PRSUs would vest at 100% for each such metric. Threshold achievement levels for which the PRSUs would vest at 50% for each such metric and maximum achievement levels for which such awards would vest at 200% for each such metric were also established. The actual payout for the PRSUs at the end of the performance period will be calculated based upon the Company's achievement of the established revenue and operating income targets for the performance period. Settlement of the PRSUs will be made in fully vested shares of common stock. During the fiscal year ended April 30, 2018, the Company recorded $269,000 of compensation expense related to the Fiscal 2018 LTIP. At April 30, 2018, the maximum compensation expense that may be recorded for the performance-based portion of the Fiscal 2018 LTIP is $2,660,000.

During the three months ended July 29, 2017, the Company also granted awards under the Restated 2006 Plan to key employees ("Fiscal 2017 LTIP"). Awards under the Fiscal 2017 LTIP consist of: (i) time-based restricted stock awards which vest in equal tranches in July 2017, July 2018 and July 2019, and (ii) PRSUs which vest based on the Company's achievement of revenue and operating income targets for the three-year period ending April 30, 2019. At the award date, target achievement levels for each of the financial performance metrics were established for the PRSUs, at which levels the PRSUs would vest at 100% for each such metric. Threshold achievement levels for which the PRSUs would vest at 50% for each such metric and maximum achievement levels for which such awards would vest at 200% for each such metric were also established. The actual payout for the PRSUs at the end of the performance period will be calculated based upon the Company's achievement of the established revenue and operating income targets for the performance period. Settlement of the PRSUs will be made in fully-vested shares of common stock. During the fiscal year ended April 30, 2018, the Company recorded $159,000 of compensation expense related to the Fiscal 2017 LTIP. At April 30, 2018, the maximum compensation expense that may be recorded for the performance-based portion of the Fiscal 2017 LTIP is $2,440,000.

During the year ended April 30, 2016, the Company granted a three-year performance award under the Restated 2006 Plan to key employees ("Fiscal 2016 LTIP"). The performance period for each three-year award is the three-year period ending April 30, 2018. A target payout was established at the award date. The actual payout at the end of the performance period will be calculated based upon the Company's achievement of revenue and gross margin for the performance period. Payouts will be made in cash and restricted stock units. Upon vesting of the restricted stock units, the Company has the discretion to settle the restricted stock units in cash or stock. No compensation cost has been recognized for this award as the Company did not achieve the performance conditions.

At each reporting period, the Company reassesses the probability of achieving the performance targets. The estimation of whether the performance targets will be achieved requires judgment, and, to the extent actual results or updated estimates differ from the Company's current estimates, the cumulative effect on current and prior periods of those changes will be recorded in the period estimates are revised.

14. Income Taxes

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

	Year Ended April 30,		
	2018	2017	2016
Domestic	$ 33,854	$ 20,954	$ 18,433
Foreign	(34)	(86)	81
Income from continuing operations before income taxes	33,820	20,868	18,514
Equity method investment activity	(1,283)	(119)	(138)
Total income from continuing operations before income taxes	$ 32,537	$ 20,749	$ 18,376

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The Company expects any foreign earnings to be reinvested in such foreign jurisdictions and, therefore, no deferred tax liabilities for U.S. income taxes on undistributed earnings are recorded. The foreign subsidiaries do not have any undistributed earnings.

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

	Year Ended April 30,					
	2018		2017		2016	
U.S. federal statutory income tax rate	30.4	%	34.0	%	35.0	%
State and local income taxes, net of federal benefit	(2.0)		(1.9)		(5.3)	
R&D and other tax credits	(6.7)		(11.7)		(19.2)	
Valuation allowance	4.7		4.1		7.3	
Foreign rate differential	0.1		—		—	
Uncertain tax position adjustment	—		—		—	
Return to provision adjustments	(0.1)		(0.3)		2.1	
Permanent items	(6.9)		(3.6)		(3.1)	
Tax Act	10.0		—		—	
Other	0.6		(0.8)		(0.7)	
Effective income tax rate	30.1	%	19.8	%	16.1	%

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

	Year Ended April 30,		
	2018	2017	2016
Current:			
Federal	$ 6,363	$ 3,745	$ 5,388
State	925	215	406
Foreign	—	—	—
	7,288	3,960	5,794
Deferred:			
Federal	3,272	(66)	(2,814)
State	(331)	279	3
Foreign	(52)	(35)	—
	2,889	178	(2,811)
Total income tax expense (benefit)	$ 10,177	$ 4,138	$ 2,983

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

	April 30, 2018	2017
Deferred income tax assets:		
Accrued expenses	$ 5,771	$ 7,074
Allowances, reserves, and other	2,100	1,801
Unrealized loss on securities	25	74
Net operating loss and credit carry-forwards	12,361	11,854
Intangibles basis	94	43
Total deferred income tax assets	20,351	20,846
Deferred income tax liabilities:		
Other	—	(29)
Fixed asset basis	(682)	(428)
Total deferred income tax liabilities	(682)	(457)
Valuation allowance	(8,568)	(5,416)
Net deferred tax assets	$ 11,101	$ 14,973

At April 30, 2018 and 2017 the Company recorded a valuation allowance of $8,568,000 and $5,416,000, respectively, against state R&D credits as the Company is currently generating more tax credits than it will utilize in future years and against foreign net operating losses that are not more likely than not to be utilized. The valuation allowance increased by $3,152,000 and $905,000 for April 30, 2018 and April 30, 2017, respectively.

At April 30, 2018 the Company had state credit carryforwards of $20,760,000 that do not expire and federal tax credit carryforwards of $5,098,000 that expire in 2035.

At April 30, 2018, the Company had multiple state net operating loss carryforwards and had foreign losses of approximately $10,000 and $1,125,000, respectively. The state net operating loss carryforwards begin to expire in 2023. $1,051,000 of the foreign loss carryforwards begin to expire in 2019 with the remainder having an indefinite carryforward.

At April 30, 2018 and 2017, the Company had approximately $11,170,000 and $9,856,000, respectively, of unrecognized tax benefits all of which would impact the Company's effective tax rate if recognized. The Company estimates that $411,000 of its unrecognized tax benefits will decrease in the next twelve months due to statute of limitation expiration.

The following table summarizes the activity related to the Company's gross unrecognized tax benefits for the years ended April 30, 2018 and 2017 (in thousands):

	April 30,	
	2018	2017
Balance as of May 1	$ 9,856	$ 9,905
Increases related to prior year tax positions	228	3
Decreases related to prior year tax positions	—	(26)
Increases related to current year tax positions	1,347	901
Decreases related to lapsing of statute of limitations	(261)	(927)
Balance as of April 30,	$ 11,170	$ 9,856

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The Company records interest and penalties on uncertain tax positions to income tax expense. As of April 30, 2018 and 2017, the Company had accrued approximately $16,000 and $16,000, respectively, of interest and penalties related to uncertain tax positions. The Company is currently under audit by various state jurisdictions but does not anticipate any material adjustments from these examinations. The tax years 2015 to 2017 remain open to examination by the IRS for federal income taxes. The tax years 2011 to 2017 remain open for major state taxing jurisdictions.

During the fiscal year ended April 30, 2018, the Company recorded a reversal of a $261,000 reserve, including the related interest, for uncertain tax positions due to the lapse of prior year statue.

On December 22, 2017, the Tax Act was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017, repeal of the corporate alternative minimum tax, repeal of the deduction for domestic production activities, and limitation on the deductibility of certain executive compensation.

In accordance with GAAP as determined by ASC 740, Income Taxes, the Company is required to record the effects of tax law changes in the period enacted. As the Company has a April 30 fiscal year end, its U.S. federal corporate income tax rate will be blended in fiscal 2018, resulting in a statutory federal rate of approximately 30.4% (8 months at 35% and 4 months at 21%), and will be 21% for subsequent fiscal years. The Company remeasured its existing deferred tax assets and liabilities at the rate the Company expects to be in effect when those deferred taxes will be realized (30.4% if in 2018 or 21% thereafter) and recorded a one-time deferred tax expense of approximately $3,400,000 for fiscal year April 30, 2018.

The Company followed the guidance in SEC Staff Accounting Bulletin 118 (“SAB 118”), which provides additional clarification regarding the application of ASC Topic 740 in situations where the Company does not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Tax Act for the reporting period in which the Act was enacted. SAB 118 provides for a measurement period beginning in the reporting period that includes the Act’s enactment date and ending when the Company has obtained, prepared, and analyzed the information needed in order to complete the accounting requirements but in no circumstances should the measurement period extend beyond one year from the enactment date.

The $3,400,000 expense for the one-time deferred tax remeasurement is a provisional estimate of the impact of the Tax Act. In addition, the Company has estimated that it will not have an income tax payable as a result of the one-time deemed repatriation transition tax on unrepatriated foreign earnings. These amounts are considered provisional because they use estimates for which final tax computations or returns have not been completed and because estimated amounts may be impacted by future regulatory and accounting guidance if and when issued.

The Company’s financial statements do not reflect the impact of certain aspects of the Tax Act as the Company did not have the necessary information available, prepared, or analyzed (including computations), or because sufficient guidance has not been issued in order to determine an actual or provisional amount for the tax effects of the Tax Act. To date, these aspects include the new state income tax conformity to the Tax Act which the Company is continuing to evaluate the provisions and as a result, has not included an estimate of the tax expense or benefit related to these items in the Company’s consolidated financial statements for the fiscal year ended April 30, 2018.

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15. Accumulated Other Comprehensive Loss

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

	Available-for-Sale Securities	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Loss	Total Accumulated Other Comprehensive Loss
Total accumulated other comprehensive loss balance as of April 30, 2017	$ (127)	$ —	$ (127)	$ (127)
Changes in foreign currency translation adjustments, net of $0 taxes	—	36	36	36
Unrealized gains, net of $25 of taxes	70	—	70	70
Total accumulated other comprehensive loss balance as of April 30, 2018	$ (57)	$ 36	$ (21)	$ (21)

16. Changes in Accounting Estimates

During the years ended April 30, 2018, 2017 and 2016, the Company revised its estimates at completion of various fixed-price contracts which resulted in cumulative catch up adjustments during the year in which the change in estimate occurred. The change in estimate was a result of the Company changing the total costs required to complete the contracts due to having more accurate cost information as work progressed in subsequent periods on the various contracts. The changes in estimates resulted in cumulative catch-up adjustments to income from continuing operations for the years ended April 30, 2018, 2017 and 2016 that were not material.

Refer also to Note 9 – Warranty Reserves for further details of change in warranty estimates during the fiscal year ended April 30, 2017.

17. Related Party Transactions

Pursuant to a consulting agreement, the Company paid a board member approximately $48,000, $80,000 and $96,000 for fiscal years ended April 30, 2018, 2017 and 2016, respectively, for consulting services independent of his board service.

Concurrent with the formation of HAPSMobile, the Company executed a Design and Development Agreement (the "DDA") with HAPSMobile. Under the DDA, the Company will use its best efforts, up to a maximum net value of $75,789,000, to design and build prototype solar powered high altitude aircraft and ground control stations for HAPSMobile and conduct low altitude and high altitude flight tests of the prototype aircraft.

The Company recorded revenue under the DDA and preliminary design agreements between the Company and SoftBank of $29,597,000 for the year ended April 30, 2018. At April 30, 2018, the Company had unbilled related party receivables from HAPSMobile of $3,145,000 recorded in "Unbilled receivables and retentions" on the consolidated balance sheet. During the year ended April 30, 2018, the Company purchased a 5% stake in accordance with the JVA. Refer to Note 8 – Equity Method Investments for further details.

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18. Commitments and Contingencies

Commitments

The Company's operations are conducted in leased facilities. The Company finances the purchase of certain IT equipment and perpetual software licenses under capital lease arrangements. Following is a summary of non cancelable operating and capital lease commitments:

	April 30, 2018 (In thousands)	
	Operating leases	Capital leases
2019	$ 4,940	$ 161
2020	4,774	—
2021	3,872	—
2022	3,421	—
2023	2,278	—
Thereafter	1,914	—
	$ 21,199	161
Less: amounts representing interest		—
Present value of capital lease obligations		161
Less: Current portion		(161)
Long-term portion of capital lease obligations		$ —

Rental expense under operating leases was approximately $4,011,000, $3,849,000 and $4,077,000 for the years ended April 30, 2018, 2017 and 2016, respectively.

Not included in the table above is an additional capital contribution of 209,500,000 yen (approximately $1,900,000) in or around January 2019 required under the Company's HAPSMobile Inc. Joint Venture Agreement – refer to footnote 8 – Investments in Companies Accounted for Using the Equity Method.

Contingencies

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

At April 30, 2018 and 2017, the Company had outstanding letters of credit totaling $6,389,000 and $1,935,000, respectively.

Contract Cost Audits

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

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

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The Company’s revenue recognition policy calls for revenue recognized on all cost reimbursable government contracts to be recorded at actual rates unless collectability is not reasonably assured. During the fiscal year ended April 30, 2017, the Company settled rates for its incurred cost claims with the DCAA for fiscal years 2011 through 2014 without payment of any consideration. At April 30, 2018, the Company had $77,000 reserved for incurred cost claim audits. At April 30, 2017, the Company had no reserves for incurred cost claim audits.

19. Business Acquisitions

On February 1, 2017, the Company completed the acquisition of 36% of the common shares of Altoy for cash consideration of $625,000, which increased its interest from 49% to 85% and provided the Company with control over Altoy. As a result, Altoy became a consolidated subsidiary of the Company on the date of the acquisition. Altoy aims to market and distribute small UAS in Turkey. The Company previously accounted for its 49% interest in Altoy as an equity method investment. As a result of the acquisition, the Company is expected to expand the sales of its small UAS and related services in Turkey.

The following table summarizes the consideration transferred to acquire Altoy and the amounts of identified assets acquired and liabilities assumed at the acquisition date, as well as the fair value of the noncontrolling interest in Altoy at the acquisition date (in thousands):

Customer relationships	$ 1,600
Goodwill	122
Trademark and trade names	60
Deferred tax liability	(332)
Other assets and liabilities assumed	286
Total net identified assets acquired	$ 1,736
Fair value of consideration transferred:	
Cash	$ 625
Fair value of the Company's investment in Altoy prior to the acquisition	851
Fair value of the noncontrolling interest in Altoy	260
Total	$ 1,736

As a result of the Company obtaining control over Altoy, the Company’s previously held 49% interest was remeasured to fair value, resulting in a gain of $584,000 which has been recognized in “other income (loss), net” on the consolidated statement of income.

The fair value of the noncontrolling interest of $260,000 and the fair value of the previously held equity interest of $851,000 in Altoy, immediately prior to the acquisition, were estimated by applying an income approach. These fair value measurements of the noncontrolling interest and the previously held equity interest are based on significant inputs not observable in the market, and thus represent Level 3 measurements.

The goodwill is attributable to the workforce of Altoy and expected future customers in the Turkey market. Goodwill is not tax deductible for tax purposes. All of the goodwill was assigned to the Company's UAS segment.

The Company tests identifiable intangible assets and goodwill for impairment in the fourth quarter of each fiscal year unless there are interim indicators that suggest that it is more likely than not that either the identifiable intangible assets or goodwill may be impaired. Due to the current political situation within Turkey and the increased uncertainty in the relations between the U.S. and Turkey, the Company significantly lowered its cash flow expectations for its Altoy operations. As a result of the decline in the Company's cash flow forecast, the Company performed an interim assessment of impairment of Altoy's long-lived assets, excluding goodwill during the three months ended October 28,

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2017. Based on the analysis, the Company determined that the fair value of Altoy had declined below its carrying value, excluding goodwill. As a result, the Company performed additional analysis to determine the amount of the impairment loss and recorded an impairment loss totaling $899,000 during the three months ended October 28, 2017, which is included in selling, general and administrative expense on the consolidated statements of operations. The fair value of the Altoy asset group was determined based on a discounted cash flow model reflective of the revised cash flow estimates.

Supplemental Pro Forma Information (unaudited)

Altoy contributed revenues of $0 and a net loss of $122,000 to the Company for the period from February 1, 2017 to April 30, 2017. The following unaudited pro forma summary presents consolidated information of the Company as if the business combination had occurred on May 1, 2015 (in thousands):

	Fiscal year ended April 30,	
	2017	2016
Revenue	$ 229,287	$ 233,941
Net income from continuing operations	$ 15,808	$ 15,595
Net income attributable to AeroVironment	$ 15,888	$ 15,666

The Company did not have any material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings.

These pro forma amounts have been calculated after applying the Company's accounting policies and adjusting the results of Altoy to reflect the additional amortization that would have been charged assuming the fair value adjustments to intangible assets had been applied from May 1, 2015, with the consequential tax effects.

The Company incurred approximately $74,000 of acquisition-related costs. These expenses are included in selling, general and administrative expense on the Company's consolidated income statement for the fiscal year ended April 30, 2017 and are reflected in pro forma net income for the fiscal year ended April 30, 2016, in the table above.

The unaudited pro forma supplemental information is based on estimates and assumptions which the Company believes are reasonable and are not necessarily indicative of the results that have been realized had the acquisitions been consolidated in the tables above as of May 1, 2015.

20. Geographic Information

Sales to non U.S. customers accounted for 46%, 37% and 29% of revenue for each of the fiscal years ended April 30, 2018, 2017 and 2016, respectively.

21. Subsequent Events

In May 2018 the Company entered into a settlement agreement to dismiss its claims against MicaSense Inc. and former AeroVironment employees, Gabriel Torres, Justin McAllister, and Jeff McBride. The terms and amount of the settlement agreement are confidential. The settlement has not been recorded in the Company's consolidated financial statements as the amount was not realized or realizable as of April 30, 2018.

22. Quarterly Results of Operations (Unaudited)

The following tables present selected unaudited consolidated financial data for each of the eight quarters in the two year period ended April 30, 2018. In the Company's opinion, this unaudited information has been prepared on the same basis as the audited information and includes all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of the financial information for the period presented. The Company's fiscal year ends on

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

	Three Months Ended						
	July 29, 2017	October 28, 2017		January 27, 2018		April 30, 2018	
	(In thousands except per share data)						
Year ended April 30, 2018							
Revenue	$ 36,250	$ 63,988		$ 53,433		$ 117,381	
Gross margin	$ 10,095	$ 28,693		$ 17,920		$ 52,180	
Net (loss) income from attributable to AeroVironment from continuing operations	$ (3,364)	$ 6,689	(1)	$ (960)	(2)	$ 20,211	
Net (loss) income per share attributable to AeroVironment from continuing operations—basic(5)	$ (0.14)	$ 0.29		$ (0.05)		$ 0.86	
Net (loss) income per share attributable to AeroVironment from continuing operations—diluted(5)	$ (0.14)	$ 0.28		$ (0.05)		$ 0.85	

	Three Months Ended					
	July 30, 2016		October 29, 2016	January 28, 2017	April 30, 2017	
	(In thousands except per share data)					
Year ended April 30, 2017						
Revenue	$ 30,496		$ 40,829	$ 41,895	$ 115,720	
Gross margin	$ 5,905		$ 15,041	$ 16,797	$ 57,442	
Net (loss) income from attributable to AeroVironment from continuing operations	$ (8,381)	(3)	$ (2,603)	$ (852)	$ 28,469	(4)
Net (loss) income per share attributable to AeroVironment from continuing operations—basic(5)	$ (0.37)		$ (0.11)	$ (0.03)	$ 1.23	
Net (loss) income per share attributable to AeroVironment from continuing operations—diluted(5)	$ (0.37)		$ (0.11)	$ (0.03)	$ 1.21	

(1) Includes an impairment loss of $1.0 million related to the Company's intangible assets and goodwill acquired in the acquisition of a controlling interest in the Company's Turkish Joint Venture, Altoy, recorded to selling, general and administrative expense in the consolidated statement of operations.

(2) Includes a one-time expense of $3.1 million resulting from the remeasurement of deferred tax assets and liabilities related to the Tax Cut and Jobs Act.

(3) Includes the reversal of a $1.0 million reserve, including the related interest, for uncertain tax positions due to the settlement of prior fiscal year tax audits.

(4) Includes a gain of $0.6 million related to the acquisition of a controlling interest in our Turkish Joint Venture, Altoy, which was recorded to other income (expense), net in the consolidated statement of operations.

(5)

Earnings per share is computed independently for each of the quarters presented. The sum of the quarterly earnings per share may not equal the total earnings per share computed for the year due to rounding.

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SUPPLEMENTARY DATA

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
	(In thousands)				
Allowance for doubtful accounts for the year ended April 30:					
2016	$ 224	$ 158	$ —	$ (326)	$ 56
2017	$ 56	$ 56	$ —	$ (8)	$ 104
2018	$ 104	$ 976	$ —	$ —	$ 1,080
Warranty reserve for the year ended April 30:					
2016	$ 1,687	$ 3,589	$ (424)	$ (1,758)	$ 3,094
2017	$ 3,094	$ 1,838	$ —	$ (2,985)	$ 1,947
2018	$ 1,947	$ 1,884	$ —	$ (1,741)	$ 2,090
Reserve for inventory excess and obsolescence for the year ended April 30:					
2016	$ 1,826	$ 2,762	$ —	$ (2,046)	$ 2,542
2017	$ 2,542	$ 1,115	$ —	$ (901)	$ 2,756
2018	$ 2,756	$ 2,758	$ —	$ (1,561)	$ 3,953
Reserve for self-insured medical claims for the year ended April 30:					
2016	$ 1,053	$ 7,668	$ —	$ (7,742)	$ 979
2017	$ 979	$ 7,037	$ —	$ (6,883)	$ 1,133
2018	$ 1,133	$ 9,100	$ —	$ (9,230)	$ 1,003

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

Not applicable.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

Management's Report on Internal Control Over Financial Reporting

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

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

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

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

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

Under the supervision and with the participation of management, including our principal executive and financial officers, we assessed our internal control over financial reporting as of April 30, 2018, based on criteria for effective internal control over financial reporting established in Internal Control—Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (COSO). Based on this assessment, management concluded that the Company maintained effective internal control over financial reporting as of April 30, 2018 based on the specified criteria.

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The effectiveness of our internal control over financial reporting as of April 30, 2018 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Changes in 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 April 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

None.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinion on Internal Control over Financial Reporting

We have audited AeroVironment, Inc. and subsidiaries' internal control over financial reporting as of April 30, 2018, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, AeroVironment, Inc. and subsidiaries (the Company) maintained, in all material respects, effective internal control over financial reporting as of April 30, 2018, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of April 30, 2018 and 2017, the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended April 30, 2018, and the related notes and financial statement schedule listed in the index at Item 15(a) and our report dated June 26, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting including in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ Ernst & Young LLP

Los Angeles, California

June 26, 2018

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PART III

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

Certain information required by Item 401 and Item 405 of Regulation S K will be included in the definitive proxy statement for our 2017 Annual Meeting of Stockholders, which will be filed no later than 120 days after April 30, 2018, and that information is incorporated by reference herein.

Codes of Ethics

We have adopted a Code of Business Conduct and Ethics, or Code of Conduct. The Code of Conduct is posted on our website, http://investor.avinc.com. We intend to disclose on our website any amendments to, or waivers of, the Code of Conduct covering our Chief Executive Officer, Chief Financial Officer and/or Controller promptly following the date of such amendments or waivers. A copy of the Code of Conduct may be obtained upon request, without charge, by contacting our Secretary at (626) 357 9983 or by writing to us at AeroVironment, Inc., Attn: Secretary, 800 Royal Oaks Drive, Suite 210, Monrovia, California 91016. The information contained on or connected to our website is not incorporated by reference into this Annual Report and should not be considered part of this or any reported filed with the SEC.

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

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

The information required by Item 407(d)(4) and (5) of Regulation S K will be included in the definitive proxy statement for our 2018 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

Item 11. Executive Compensation.

The information required by Item 402 and Item 407(e)(4) and (5) of Regulation S K will be included in the definitive proxy statement for our 2018 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

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

The information required by Item 201(d) and Item 403 of Regulation S K will be included in the definitive proxy statement for our 2018 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

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

The information required by Item 404 and Item 407(a) of Regulation S K will be included in the definitive proxy statement for our 2018 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

Item 14. Principal Accounting Fees and Services.

The information required by Item 14 of Form 10-K will be included in the definitive proxy statement for our 2018 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

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PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) The following are filed as part of this Annual Report:

1. Financial Statements

The following consolidated financial statements are included in Item 8:

· Report of Independent Registered Public Accounting Firm

· Consolidated Balance Sheets at April 30, 2018 and 2017

· Consolidated Statements of Income for the Years Ended April 30, 2018, 2017 and 2016

· Consolidated Statements of Comprehensive Income for the Years Ended April 30, 2018, 2017 and 2016

· Consolidated Statements of Stockholders' Equity for the Years Ended April 30, 2018, 2017 and 2016

· Consolidated Statements of Cash Flows for the Years Ended April 30, 2018, 2017 and 2016

· Notes to Consolidated Financial Statements

2. Financial Statement Schedules

The following Schedule is included in Item 8:

· Schedule II—Valuation and Qualifying Accounts

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

3. Exhibits

See Item 15(b) of this report below.

(b) Exhibits

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

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Exhibit Number	Exhibit
10.8#(3)	AeroVironment, Inc. 2006 Equity Incentive Plan
10.9#(5)	AeroVironment, Inc. 2006 Equity Incentive Plan, as amended and restated effective September 29, 2011
10.10#(6)	AeroVironment, Inc. 2006 Equity Incentive Plan, as amended and restated effective September 30, 2016
10.11#(3)	Form of Stock Option Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.12#(3)	Form of Performance Based Bonus Award pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.13#(7)	Form of Long Term Compensation Award Grant Notice and Long Term Compensation Award Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.14#(2)	Form of Restricted Stock Award Grant Notice and Restricted Stock Award Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.15#(6)	Form of Performance Restricted Stock Unit Award Grant Notice and Performance Restricted Stock Unit Award Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.16(8)	Standard Industrial/Commercial Single Tenant Lease, dated February 12, 2007, between AeroVironment, Inc. and OMP Industrial Moreland, LLC, for the property located at 85 Moreland Road, Simi Valley, California, including the addendum thereto
10.17(6)	First Amendment to Lease Agreement dated October 10, 2011 and Second Amendment to Lease Agreement dated June 2, 2017 by and between AeroVironment, Inc. and Simi Valley-NCR, LLC for the property located at 85 Moreland Road, Simi Valley, California
10.18(9)	Standard Industrial/Commercial Single Tenant Lease, dated March 3, 2008, between AeroVironment, Inc. and Hillside Associates III, LLC, for the property located at 900 Enchanted Way, Simi Valley, California, including the addendum thereto
10.19(9)	Standard Industrial/Commercial Single Tenant Lease, dated April 21, 2008, between AeroVironment, Inc. and Hillside Associates II, LLC, for the property located at 994 Flower Glen Street, Simi Valley, California, including the addendum thereto
10.20(10)	First Amendment to Lease Agreement (900 Enchanted Way, Simi Valley, CA 93065) dated as of December 1, 2013, by and between the Company and Hillside III LLC, and related agreements
10.21(10)	First Amendment to Lease Agreement (994 Flower Glen Street, Simi Valley, CA 93065) dated as of December 1, 2013, by and between the Company and Hillside II LLC, and related agreements
10.22(10)	Lease Agreement (996 Flower Glen Street, Simi Valley, CA 93065) dated as of December 1, 2013, by and between the Company and Hillside II LLC, and related agreements
10.23(11)	Standard Multi-Tenant Office Lease — Gross, dated September 24, 2015, between AeroVironment, Inc. and Monrovia Technology Campus LLC for property at 800 Royal Oaks Dr. Monrovia, California, including addendums thereto
10.24	Lease dated March 28, 2018 between AeroVironment, Inc. and Princeton Avenue Holdings, LLC for property located at 14501 Princeton Avenue, Moorpark, California, including addendums thereto
10.25#(3)	Retiree Medical Plan
10.26†(12)	Award Contract, dated March 1, 2011, between AeroVironment, Inc. and United States Army Contracting Command
10.27†(13)	Contract modification P00015 dated September 5, 2013 under the base contract with the US Army Contracting Command—Redstone Arsenal (Missile) dated August 30, 2012
10.28†(14)	Contract modification P00074 dated September 27, 2016 under the base contract with the US Army Contracting Command — Redstone Arsenal (Missile) dated August 30, 2012
10.29(15)	Consulting Agreement, dated February 5, 2015, between Jikun Kim and AeroVironment, Inc.

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Exhibit Number	Exhibit
10.30#(16)	Offer Letter, dated June 15, 2015 from AeroVironment, Inc. to Raymond D. Cook
10.31#(17)	Form of Severance Protection Agreement dated as of December 10, 2015, by and between AeroVironment, Inc. and each non-CEO executive officer
10.32(17)	Form of Director Letter Agreement by and between AeroVironment, Inc. and each non-employee director
10.33#(18)	Separation Agreement by and between AeroVironment, Inc. and Cathleen Cline dated as of April 28, 2016
10.34(18)	Consulting Agreement by and between AeroVironment, Inc. and Cathleen Cline dated as of April 28, 2016
10.35(19)	Severance Agreement and General Release by and between AeroVironment, Inc. and Raymond Cook dated as of December 19, 2016
10.36(4)	Severance Protection Agreement dated as of May 2, 2016, by and between AeroVironment, Inc. and Wahid Nawabi
10.37#(6)	Amended and Restated Severance Protection Agreement dated as of June 26, 2017, by and between AeroVironment, Inc. and Teresa Covington
10.38(4)	Consulting Agreement by and between AeroVironment, Inc. and Charles R. Holland executed as of March 7, 2016
10.39(4)	Task Order #FY16-001 to Consulting Agreement by and between AeroVironment, Inc. and Charles R. Holland executed as of March 7, 2016
10.40	Amendment No. 1 dated November 28, 2016, Amendment No. 2 dated June 7, 2017, and Amendment No. 3 dated April 23, 2018 to Standard Consulting Agreement and corresponding Task Orders by and between AeroVironment, Inc. and Charles R. Holland
10.41#(20)	Amended and Restated Severance Protection Agreement by and between AeroVironment, Inc. and Melissa Brown dated as of March 5, 2018
10.42†(20)	Joint Venture Agreement by and between AeroVironment, Inc. and SoftBank Corp. dated as of December 1, 2017
10.43†(20)	Design and Development Agreement by and between AeroVironment, Inc. and HAPSMobile, Inc. dated as of December 27, 2017
10.44†(20)	Intellectual Property License Agreement by and among AeroVironment, Inc., SoftBank Corp. and HAPSMobile, Inc. dated as of December 27, 2017.
21.1	Subsidiaries of AeroVironment, Inc.
23.1	Consent of Ernst & Young LLP, independent registered public accounting firm
24.1	Power of Attorney (incorporated by reference to the signature page of this Annual Report)
31.1	Certification Pursuant to Rule 13a 14(a) or Rule 15d 14(a) of the Securities Exchange Act of 1934
31.2	Certification Pursuant to Rule 13a 14(a) or Rule 15d 14(a) of the Securities Exchange Act of 1934
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

(1)

Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10 Q filed March 9, 2007 (File No. 001 33261).

(2) Incorporated by reference herein to the exhibits to the Company's Annual Report on Form 10-K filed July 1, 2015 (File No. 001-33261).

(3) Incorporated by reference herein to the exhibits to the Company's Registration Statement on Form S 1 (File No. 333 137658).

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(4) Incorporated by reference herein to the exhibits to the Company’s Annual Report on Form 10 K filed on June 29, 2016 (File No. 001 33261).

(5) Incorporated by reference to the exhibits to the Company’s Form 8 K filed on October 5, 2011 (File No. 001 33261).

(6) Incorporated by reference herein to the exhibits to the Company’s Annual Report on Form 10-K filed June 28, 2017 (File No. 001-33261).

(7) Incorporated by reference herein to the exhibits to the Company’s Current Report on Form 8 K filed July 28, 2010 (File No. 001 33261).

(8) Incorporated by reference herein to the exhibits on the Company’s Annual Report on Form 10 K filed June 29, 2007 (File No. 001 33261).

(9) Incorporated by reference herein to the exhibits to the Company’s Annual Report on Form 10 K filed June 26, 2008 (File No. 001 33261).

(10) Incorporated by reference herein to the exhibits to the Company’s Quarterly Report on Form 10 Q filed March 5, 2014 (File No. 001 33261).

(11) Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10-Q filed December 9, 2015 (File No. 001-33261).

(12) Incorporated by reference herein to the exhibits to the Company’s Annual Report on Form 10 K filed on June 21, 2011 (File No. 001 33261).

(13) Incorporated by reference herein to the exhibits to the Company’s Quarterly Report on Form 10 Q filed November 27, 2013 (File No. 001 33261).

(14) Incorporated by reference herein to the exhibits to the Company’s Quarterly Report on Form 10 Q filed December 7, 2016 (File No. 001 33261).

(15) Incorporated by reference herein to the exhibits to the Company’s Current Report on Form 8 K filed February 5, 2015 (File No. 001 33261).

(16) Incorporated by reference herein to the exhibits to the Company's Current Report on Form 8-K filed July 7, 2015 (File No. 001-33261).

(17) Incorporated by reference herein to the exhibits to the Company's Quarterly Report on Form 10-Q filed March 9, 2016 (File No. 001-33261).

(18) Incorporated by reference herein to the exhibits to the Company's Current Report on Form 8-K filed May 4, 2016 (File No. 001-33261).

(19) Incorporated by reference herein to the exhibits to the Company’s Current Report on Form 8-K filed December 20, 2016 (File No. 001-33261).

(20) Incorporated by reference herein to the exhibits to the Company’s Quarterly Report on Form 10-Q filed March 7, 2018 (File No. 001-33261).

†Confidential treatment has been granted for portions of this exhibit.

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#Indicates management contract or compensatory plan.

(c)Not applicable.

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SIGNATURES

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

		AEROVIRONMENT, INC.
Date: June 26, 2018		/s/ Wahid Nawabi
	By:	Wahid Nawabi
	Its:	Chief Executive Officer and President (Principal Executive Officer)

POWER OF ATTORNEY

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

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

Name	Title	Date
/s/ Wahid Nawabi Wahid Nawabi	President, Chief Executive Officer and Director (Principal Executive Officer)	June 26, 2018
/s/ Teresa P. Covington Teresa P. Covington	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	June 26, 2018
/s/ Timothy E. Conver	Chairman	June 26, 2018

Timothy E. Conver

/s/ Edward R. Muller Edward R. Muller	Director	June 26, 2018
/s/ Arnold L. Fishman Arnold L. Fishman	Director	June 26, 2018
/s/ Stephen F. Page Stephen F. Page	Director	June 26, 2018
/s/ Charles R. Holland Charles R. Holland	Director	June 26, 2018
/s/ Catharine Merigold Catharine Merigold	Director	June 26, 2018
/s/ Charles Thomas Burbage Charles Thomas Burbage	Director	June 26, 2018