# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended October 27, 2018**

**OR**

☐ **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**<br>(State or other jurisdiction of incorporation or organization) | **95-2705790**<br>(I.R.S. Employer Identification No.) |
| **900 Innovators Way**<br>**Simi Valley, California**<br>(Address of principal executive offices) | **93065**<br>(Zip Code) |

**(805) 520-8350**
(Registrant's telephone number, including area code)

**800 Royal Oaks Drive, Suite 210**
**Monrovia, California 91016**
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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 ☐ |
| Non-accelerated filer ☐ | 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 Exchange Act). Yes ☐ No ☒

As of November 21, 2018, the number of shares outstanding of the registrant's common stock, $0.0001 par value, was 23,928,373.

**AeroVironment, Inc.**

**Table of Contents**

## PART I. FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

**AeroVironment, Inc.**
**Consolidated Balance Sheets**
**(In thousands except share and per share data)**

| | October 27, 2018 (Unaudited) | April 30, 2018 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 151,255 | $ 143,517 |
| Short-term investments | 138,536 | 113,649 |
| Accounts receivable, net of allowance for doubtful accounts of $1,054 at October 27, 2018 and $1,080 at April 30, 2018 | 34,639 | 56,813 |
| Unbilled receivables and retentions (inclusive of related party unbilled receivables of $7,764 at October 27, 2018 and $3,145 at April 30, 2018) | 45,654 | 16,872 |
| Inventories, net | 46,096 | 37,425 |
| Prepaid expenses and other current assets | 5,732 | 5,103 |
| Current assets of discontinued operations | — | 25,668 |
| Total current assets | 421,912 | 399,047 |
| Long-term investments | 30,459 | 40,656 |
| Property and equipment, net | 20,460 | 19,219 |
| Deferred income taxes | 12,108 | 11,494 |
| Other assets | 1,628 | 3,002 |
| Total assets | $ 486,567 | $ 473,418 |
| **Liabilities and stockholders' equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 14,149 | $ 21,340 |
| Wages and related accruals | 11,071 | 16,851 |
| Income taxes payable | 4,851 | 4,085 |
| Customer advances | 2,449 | 3,564 |
| Other current liabilities | 6,971 | 6,954 |
| Current liabilities of discontinued operations | — | 9,294 |
| Total current liabilities | 39,491 | 62,088 |
| Deferred rent | 1,478 | 1,536 |
| Other non-current liabilities | 1,306 | 622 |
| Deferred tax liability | 67 | 67 |
| Liability for uncertain tax positions | 49 | 49 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, $0.0001 par value: | | |
| Authorized shares—10,000,000; none issued or outstanding at October 27, 2018 and April 30, 2018 | — | — |
| Common stock, $0.0001 par value: | | |
| Authorized shares—100,000,000 | | |
| Issued and outstanding shares—23,928,373 shares at October 27, 2018 and 23,908,736 at April 30, 2018 | 2 | 2 |
| Additional paid-in capital | 171,867 | 170,139 |
| Accumulated other comprehensive income (loss) | 5 | (21) |
| Retained earnings | 272,300 | 238,913 |
| Total AeroVironment stockholders' equity | 444,174 | 409,033 |
| Noncontrolling interest | 2 | 23 |
| Total equity | 444,176 | 409,056 |
| Total liabilities and stockholders' equity | $ 486,567 | $ 473,418 |

See accompanying notes to consolidated financial statements (unaudited).

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

| | Three Months Ended October 27, 2018 | Three Months Ended October 28, 2017 | Six Months Ended October 27, 2018 | Six Months Ended October 28, 2017 |
|---|---|---|---|---|
| Revenue: | | | | |
| Product sales | $ 47,056 | $ 48,420 | $ 102,369 | $ 67,200 |
| Contract services (inclusive of related party revenue of $12,832 and $7,071 for the three months ended October 27, 2018 and October 28, 2017, respectively; and inclusive of related party revenue of $24,395 and $9,622 for the six months ended October 27, 2018 and October 28, 2017, respectively) | 25,923 | 17,381 | 48,653 | 32,962 |
| | 72,979 | 65,801 | 151,022 | 100,162 |
| Cost of sales: | | | | |
| Product sales | 26,567 | 25,196 | 56,378 | 41,168 |
| Contract services | 18,013 | 10,462 | 33,656 | 20,153 |
| | 44,580 | 35,658 | 90,034 | 61,321 |
| Gross margin: | | | | |
| Product sales | 20,489 | 23,224 | 45,991 | 26,032 |
| Contract services | 7,910 | 6,919 | 14,997 | 12,809 |
| | 28,399 | 30,143 | 60,988 | 38,841 |
| Selling, general and administrative | 13,646 | 12,768 | 25,602 | 24,055 |
| Research and development | 8,109 | 6,844 | 14,544 | 12,386 |
| Income from continuing operations | 6,644 | 10,531 | 20,842 | 2,400 |
| Other income: | | | | |
| Interest income, net | 1,068 | 432 | 1,974 | 944 |
| Other income (expense), net | 1,291 | (55) | 9,679 | (51) |
| Income from continuing operations before income taxes | 9,003 | 10,908 | 32,495 | 3,293 |
| Provision for income taxes | 1,211 | 3,358 | 3,778 | 137 |
| Equity method investment activity, net of tax | (752) | — | (1,354) | — |
| Net income from continuing operations | 7,040 | 7,550 | 27,363 | 3,156 |
| Discontinued operations: | | | | |
| (Loss) gain on sale of business, net of tax (benefit) expense of $(114) and $2,463 for the three and six months ended October 27, 2018, respectively | (391) | — | 8,452 | — |
| Loss from discontinued operations, net of tax | (599) | (33) | (2,449) | (1,521) |
| Net (loss) income from discontinued operations | (990) | (33) | 6,003 | (1,521) |
| Net income | 6,050 | 7,517 | 33,366 | 1,635 |
| Net loss attributable to noncontrolling interest | 7 | 206 | 21 | 229 |
| Net income attributable to AeroVironment | $ 6,057 | $ 7,723 | $ 33,387 | $ 1,864 |
| Net income (loss) per share attributable to AeroVironment—Basic | | | | |
| Continuing operations | $ 0.30 | $ 0.33 | $ 1.16 | $ 0.14 |
| Discontinued operations | (0.04) | — | 0.25 | (0.06) |
| Net income per share attributable to AeroVironment—Basic | $ 0.26 | $ 0.33 | $ 1.41 | $ 0.08 |
| Net income (loss) per share attributable to AeroVironment—Diluted | | | | |
| Continuing operations | $ 0.29 | $ 0.32 | $ 1.14 | $ 0.14 |
| Discontinued operations | (0.04) | — | 0.25 | (0.06) |
| Net income per share attributable to AeroVironment—Diluted | $ 0.25 | $ 0.32 | $ 1.39 | $ 0.08 |
| Weighted-average shares outstanding: | | | | |
| Basic | 23,667,400 | 23,477,914 | 23,621,720 | 23,407,500 |
| Diluted | 24,098,833 | 23,832,959 | 24,059,394 | 23,715,997 |

See accompanying notes to consolidated financial statements (unaudited).

**AeroVironment, Inc.**
**Consolidated Statements of Comprehensive Income (Unaudited)**
**(In thousands)**

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | October 27, 2018 | October 28, 2017 | October 27, 2018 | October 28, 2017 |
| Net income | $ 6,050 | $ 7,517 | $ 33,366 | $ 1,635 |
| Other comprehensive income: | | | | |
| Change in foreign currency translation adjustments | (11) | — | (31) | — |
| Unrealized gain on investments, net of deferred tax expense of $0 and $17 for the three months ended October 27, 2018 and October 28, 2017, respectively; and net of deferred tax expense of $51 and $19 for the six months ended October 27, 2018 and October 28, 2017, respectively | — | 26 | 57 | 29 |
| Total comprehensive income | 6,039 | $ 7,543 | 33,392 | 1,664 |
| Net loss attributable to noncontrolling interest | 7 | 206 | 21 | 229 |
| Comprehensive income attributable to AeroVironment | $ 6,046 | $ 7,749 | $ 33,413 | $ 1,893 |

See accompanying notes to consolidated financial statements (unaudited).

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

| | Six Months Ended October 27, 2018 | Six Months Ended October 28, 2017 |
|---|---|---|
| **Operating activities** | | |
| Net income | $ 33,366 | $ 1,635 |
| Gain on sale of business, net of tax | (8,452) | — |
| Loss from discontinued operations, net of tax | 2,449 | 1,521 |
| Net income from continuing operations | 27,363 | 3,156 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 3,584 | 2,784 |
| Loss from equity method investment | 1,354 | — |
| Impairment of long-lived assets | — | 255 |
| Provision for doubtful accounts | (27) | 935 |
| Impairment of intangible assets and goodwill | — | 1,021 |
| Gains on foreign currency transactions | (13) | (108) |
| Deferred income taxes | (614) | (1,094) |
| Stock-based compensation | 2,517 | 2,535 |
| Loss on disposition of property and equipment | — | 15 |
| Amortization of held-to-maturity investments | (459) | 897 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 22,261 | 39,861 |
| Unbilled receivables and retentions | (28,782) | 600 |
| Inventories | (8,671) | (13,772) |
| Income tax receivable | — | (307) |
| Prepaid expenses and other assets | (831) | 413 |
| Accounts payable | (8,841) | (2,972) |
| Other liabilities | (6,184) | (4,225) |
| Net cash provided by operating activities of continuing operations | 2,657 | 29,994 |
| **Investing activities** | | |
| Acquisition of property and equipment | (4,135) | (5,455) |
| Proceeds from sale of business | 31,994 | — |
| Redemptions of held-to-maturity investments | 153,029 | 105,758 |
| Purchases of held-to-maturity investments | (169,402) | (88,763) |
| Redemptions of available-for-sale investments | 2,250 | 450 |
| Net cash provided by investing activities from continuing operations | 13,736 | 11,990 |
| **Financing activities** | | |
| Principal payments of capital lease obligations | (111) | (173) |
| Tax withholding payment related to net settlement of equity awards | (975) | (313) |
| Exercise of stock options | 71 | 2,164 |
| Net cash (used in) provided by financing activities from continuing operations | (1,015) | 1,678 |
| **Discontinued operations** | | |
| Operating activities of discontinued operations | (7,188) | (5,875) |
| Investing activities of discontinued operations | (452) | (582) |
| Financing activities of discontinued operations | — | — |
| Net cash used in discontinued operations | (7,640) | (6,457) |
| Net increase in cash and cash equivalents | 7,738 | 37,205 |
| Cash and cash equivalents at beginning of period | 143,517 | 79,904 |
| Cash and cash equivalents at end of period | $ 151,255 | $ 117,109 |
| **Supplemental disclosures of cash flow information** | | |
| Cash paid, net during the period for: | | |
| Income taxes | $ 5,270 | $ 1,803 |
| **Non-cash activities** | | |
| Unrealized gain on investments, net of deferred tax expense of $51 and $19, respectively | $ 57 | $ 29 |
| Reclassification from share-based liability compensation to equity | $ — | $ 384 |
| Change in foreign currency translation adjustments | $ (31) | $ — |
| Acquisitions of property and equipment included in accounts payable | $ 753 | $ 888 |

See accompanying notes to consolidated financial statements (unaudited).

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

## 1. Organization and Significant Accounting Policies

***Organization***

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

***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three and six months ended October 27, 2018 are not necessarily indicative of the results for the full year ending April 30, 2019. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended April 30, 2018, included in the Company's Annual Report on Form 10-K.

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

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

The accompanying consolidated financial statements include the balance sheet and results of operations of Altoy Savunma Sanayi ve Havacilik Anonim Sirketi ("Altoy"), in which the Company increased its ownership to a controlling interest of 85% during the fourth quarter of the fiscal year ended April 30, 2017. Prior to the increase in ownership, the Company's investment in Altoy was accounted for under the equity method.

In December 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 has been accounted for 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 statements of operations. The carrying value of the investment in HAPSMobile was recorded in "Other assets." Refer to Note 6—Equity Method Investments for further details.

On June 29, 2018, the Company completed the sale of substantially all of the assets and related liabilities of its efficient energy systems business segment ("the EES Business") to Webasto Charging Systems, Inc. ("Webasto") pursuant to an Asset Purchase Agreement (the "Purchase Agreement") between Webasto and the Company. The Company determined that the EES Business met the criteria for classification as an asset held for sale at April 30, 2018 and represents a strategic shift in the Company's operations. Therefore, the assets and liabilities and the results of operations of the EES Business are reported as discontinued operations for all periods presented. Refer to Note 2—Discontinued Operations for further details.

***Recently Adopted Accounting Standards***

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 Company's adoption of ASU No. 2017-01 effective May 1, 2018 did not have a material impact on its consolidated financial statements.

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 Company's adoption of ASU No. 2017-01 effective May 1, 2018 did not have a material impact on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation—Stock Compensation* (Topic 718). This ASU reduces the diversity in practice and cost and complexity when applying the guidance in Topic 718 to a change in terms or conditions of a share-based payment award. The Company's adoption of ASU No. 2017-09 effective May 1, 2018 did not have a material impact on its consolidated financial statements.

In the first quarter of its fiscal 2019, the Company adopted ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606), using the full retrospective method. Topic 606 requires revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services.

Revenue for small UAS product contracts with both the U.S. government and foreign governments under the new standard will be recognized at the point in time when the transfer of control passes to the customer, which is generally when title and risk of loss transfer. Revenue for Tactical Missile Systems ("TMS") contracts will now be recognized under the new standard over time as costs are incurred. Under previous U.S. GAAP, revenue was generally recognized when deliveries of the related TMS products were made. The new standard accelerates the timing of when the revenue is recognized; however, it does not change the total amount of revenue recognized on these contracts. The new standard does not affect revenue recognition for the Company's Customer-Funded Research and Development ("R&D") contracts. The Company continues to recognize revenue for these contracts over time as costs are incurred. The adoption of Topic 606 resulted in a cumulative adjustment to decrease retained earnings by $1,084,000 at May 1, 2018 relating to both the Company's continuing and discontinued operations. For the Company's continuing operations, the adoption of Topic 606 resulted in a cumulative adjustment to increase retained earnings by $1,063,000 at May 1, 2018.

The Company applied the standard's practical expedient that permits the omission of prior-period information about the Company's remaining performance obligations, the practical expedient that permits the Company to recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset the entity otherwise would have recognized is one year or less, and the practical expedient that permits the Company to not retrospectively restate contracts which were modified prior to the Company's initial date of adoption, or May 1, 2016. Instead the Company reflected the aggregate effect of all modifications when identifying the satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price. No other practical expedients were applied.

***Revenue Recognition***

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 customers. These contracts may be firm fixed price ("FFP"), cost plus fixed fee ("CPFF"), or time and materials ("T&M"). The Company considers all such contracts to be within the scope of ASC Topic 606.

***Performance Obligations***

A performance obligation is a promise in a contract to transfer distinct goods or services to a customer, and it is the unit of account in ASC Topic 606. A contract's transaction price is allocated to each distinct performance obligation and revenue is recognized when each performance obligation under the terms of a contract is satisfied. Revenue is measured at the amount of consideration the Company expects to receive in exchange for transferring goods or providing services. For contracts with multiple performance obligations, the Company allocates the contract's transaction price to each performance obligation using its observable standalone selling price for products and services. When the standalone selling price is not directly observable, the Company uses its best estimate of the standalone selling price of each distinct good or service in the contract using the cost plus margin approach. This approach estimates the Company's expected costs of satisfying the performance obligation and then adds an appropriate margin for that distinct good or service.

Contract modifications are routine in the performance of the Company's contracts. In most instances, contract modifications are for additional goods and/or services that are distinct and, therefore, accounted for as new contracts.

The Company's performance obligations are satisfied over time or at a point in time. Performance obligations are satisfied over time if the customer receives the benefits as the Company performs, if the customer controls the asset as it is being developed or produced, or if the product being produced for the customer has no alternative use and the Company has a contractual right to payment for the Company's costs incurred to date plus a reasonable margin. The contractual right to payment is generally supported by termination for convenience clauses that allow the customer to unilaterally terminate the contract for convenience, pay the Company for costs incurred plus a reasonable profit, and take control of any work in process. Revenue for TMS product deliveries and Customer-Funded R&D contracts is recognized over time as costs are incurred. Contract services revenue is composed of revenue recognized on contracts for the provision of services, including repairs and maintenance, training, engineering design, development and prototyping activities, and technical support services. Contract services revenue is recognized over time as services are rendered. Typically, revenue is recognized over time using an input measure (e.g., costs incurred to date relative to total estimated costs at completion) to measure progress. Training services are recognized over time using an output method based on days of training completed.

For performance obligations satisfied over time, revenue is generally recognized using costs incurred to date relative to total estimated costs at completion to measure progress. Incurred costs represent work performed, which correspond with, and thereby best depict, transfer of control to the customer. Contract costs include labor, materials, subcontractors' costs, other direct costs, and indirect costs applicable on government and commercial contracts.

For performance obligations which are not satisfied over time per the aforementioned criteria above, revenue is recognized at the point in time in which each performance obligation is fully satisfied. The Company's small UAS product sales revenue is composed of revenue recognized on contracts for the delivery of small UAS systems and spare parts. Revenue is recognized at the point in time when control transfers to the customer, which generally occurs when title and risk of loss have passed to the customer.

On October 27, 2018, the Company had approximately $163,852,000 of remaining performance obligations under fully funded contracts with its customers, which the Company also refers to as funded backlog. The Company currently expects to recognize approximately 77% of the remaining performance obligations as revenue in fiscal 2019, an additional 17% in fiscal 2020, and the balance thereafter.

The Company collects sales, value add, and other taxes concurrent with revenue producing activities, which are excluded from revenue when they are both imposed on a specific transaction and collected from a customer.

***Contract Estimates***

Accounting for contracts and programs primarily with a duration of less than six months involves the use of various techniques to estimate total contract revenue and costs. For long-term contracts, the Company estimates the total expected costs to complete the contract and recognizes revenue based on the percentage of costs incurred at period end. Typically, revenue is recognized over time using costs incurred to date relative to total estimated costs at completion to measure progress toward satisfying the Company's performance obligations. Incurred costs represent work performed, which corresponds with, and thereby best depicts, the transfer of control to the customer. Contract costs include labor, materials, subcontractors' costs, other direct costs, and indirect costs applicable on government and commercial contracts.

Contract estimates are based on various assumptions to project the outcome of future events that may span several years. These assumptions include labor productivity and availability, the complexity of the work to be performed, the cost and availability of materials, the performance of subcontractors, and the availability and timing of funding from the customer.

The nature of the Company's contracts gives rise to several types of variable consideration, including penalty fees and incentive awards generally for late delivery and early delivery, respectively. The Company generally estimates such variable consideration as the most likely amount. In addition, the Company includes the estimated variable consideration to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the related uncertainty is resolved. These estimates are based on historical award experience, anticipated performance and the Company's best judgment at the time. Because of the certainty in estimating these amounts, they are included in the transaction price of the Company's contracts and the associated remaining performance obligations.

As a significant change in one or more of these estimates could affect the profitability of the Company's contracts, the Company regularly reviews and updates its contract-related estimates. Changes in cumulative revenue estimates, due to changes in the estimated transaction price or cost estimates, are recorded using a cumulative catch-up adjustment in the period identified for contracts with performance obligations recognized over time. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, the Company recognizes the total loss in the quarter it is identified.

The impact of adjustments in contract estimates on the Company's operating earnings can be reflected in either operating costs and expenses or revenue. The aggregate impact of adjustments in contract estimates on revenue related to performance obligations satisfied or partially satisfied in previous periods was not significant for the three or six month periods ended October 27, 2018 and October 28, 2017. No adjustment on any one contract was material to the Company's unaudited consolidated financial statements for the three and six month periods ended October 27, 2018 and October 28, 2017.

***Revenue by Category***

Revenue from products and services during the six months ended October 27, 2018 consisted of revenue derived from over 230 active contracts. The following tables present the Company's revenue disaggregated by major product line, contract type, customer category and geographic location (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| **Revenue by major product line/program** | **October 27, 2018** | **October 28, 2017** | **October 27, 2018** | **October 28, 2017** |
| Small UAS | $ 42,199 | $ 47,021 | $ 83,415 | $ 67,082 |
| TMS | 15,019 | 9,366 | 37,785 | 18,931 |
| HAPS | 12,832 | 7,071 | 24,395 | 9,622 |
| Other | 2,929 | 2,343 | 5,427 | 4,527 |
| Total revenue | $ 72,979 | $ 65,801 | $ 151,022 | $ 100,162 |

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| **Revenue by contract type** | **October 27, 2018** | **October 28, 2017** | **October 27, 2018** | **October 28, 2017** |
| FFP | $ 50,054 | $ 56,761 | $ 108,057 | $ 82,615 |
| CPFF | 22,870 | 8,948 | 42,853 | 17,321 |
| T&M | 55 | 92 | 112 | 226 |
| Total revenue | $ 72,979 | $ 65,801 | $ 151,022 | $ 100,162 |

Each of these contract types presents advantages and disadvantages. Typically, the Company assumes more risk with FFP contracts. However, these types of contracts generally offer additional profits when the Company completes the work for less than originally estimated. CPFF contracts generally subject the Company to lower risk. Accordingly, the associated base fees are usually lower than fees on FFP contracts. Under T&M contracts, the Company's profit may vary if actual labor hour rates vary significantly from the negotiated rates.

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| **Revenue by customer category** | **October 27, 2018** | **October 28, 2017** | **October 27, 2018** | **October 28, 2017** |
| U.S. government: | $ 46,941 | $ 40,578 | $ 82,849 | $ 63,471 |
| Non-U.S. government | 26,038 | 25,223 | 68,173 | 36,691 |
| Total revenue | $ 72,979 | $ 65,801 | $ 151,022 | $ 100,162 |

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| **Revenue by geographic location** | **October 27, 2018** | **October 28, 2017** | **October 27, 2018** | **October 28, 2017** |
| Domestic | $ 46,726 | $ 39,170 | $ 82,078 | $ 60,740 |
| International | 26,253 | 26,631 | 68,944 | 39,422 |
| Total revenue | $ 72,979 | $ 65,801 | $ 151,022 | $ 100,162 |

***Contract Balances***

The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables, and customer advances and deposits on the consolidated balance sheet. In the Company's services contracts, amounts are billed as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals, which is generally monthly, or upon the achievement of contractual milestones. Generally, billing occurs subsequent to revenue recognition, resulting in contract assets recorded in "Unbilled receivables and retentions" on the consolidated balance sheet. However, the Company sometimes receives advances or deposits from its customers before revenue is recognized, resulting in contract liabilities recorded in "Customer advances" on the consolidated balance sheet. Contract liabilities are not a significant financing component as they are generally utilized to pay for contract costs within a one-year period or are used to ensure the customer meets contractual requirements. These assets and liabilities are reported on the consolidated balance sheet on a contract-by-contract basis at the end of each reporting period. For the Company's product revenue, the Company generally receives cash payments subsequent to satisfying the performance obligation via delivery of the product, resulting in billed accounts receivable. Changes in the contract asset and liability balances during the six-month period ended October 27, 2018 were not materially impacted by any other factors. For the Company's contracts, there are no significant gaps between the receipt of payment and the transfer of the associated goods and services to the customer for material amounts of consideration.

Revenue recognized for the three month periods ended October 27, 2018 and October 28, 2017 that was included in contract liability balances at the beginning of each year were $6,000 and $0, respectively; and revenue recognized for the six month periods ended October 27, 2018 and October 28, 2017 that was included in contract liability balances at the beginning of each year were $1,554,000 and $764,000, respectively.

***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 R&D, on a consolidated basis for the Company's continuing operations. Accordingly, the Company operates its business as a single reportable segment.

***Investments***

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

***Fair Values of Financial Instruments***

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

***Government Contracts***

Payments to the Company on government CPFF or T&M 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.

The Company's revenue recognition policy calls for revenue recognized on all CPFF or T&M 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 October 27, 2018 and April 30, 2018, the Company had $179,000 and $77,000 reserved for incurred cost claim audits, respectively.

**Earnings Per Share**

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

The reconciliation of basic to diluted shares is as follows (in thousands except share data):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| Income (loss) from | October 27, 2018 | October 28, 2017 | October 27, 2018 | October 28, 2017 |
| Continuing operations attributable to AeroVironment | $ 7,047 | $ 7,756 | $ 27,384 | $ 3,385 |
| Discontinued operations, net of tax | (990) | (33) | 6,003 | (1,521) |
| Net income attributable to AeroVironment | $ 6,057 | $ 7,723 | $ 33,387 | $ 1,864 |
| Denominator for basic earnings per share: | | | | |
| Weighted average common shares | 23,667,400 | 23,477,914 | 23,621,720 | 23,407,500 |
| Dilutive effect of employee stock options, restricted stock and restricted stock units | 431,433 | 355,045 | 437,674 | 308,497 |
| Denominator for diluted earnings per share | 24,098,833 | 23,832,959 | 24,059,394 | 23,715,997 |

Potentially dilutive shares not included in the computation of diluted weighted-average common shares because their effect would have been anti-dilutive were 598 and 7,130 for the three and six months ended October 27, 2018, respectively. There were no potentially dilutive shares for the three months ended October 27, 2018. Potentially dilutive shares not included in the computation of diluted weighted average common shares because their effect would have been antidilutive were 14,820 for the six months ended October 28, 2017, respectively.

***Recently Issued Accounting Standards***

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. The Company plans to adopt Topic 842 using the required modified retrospective approach with the election to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. 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 February 2018, the FASB issued ASU 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* This ASU permits but does not require the Company to reclassify the disproportionate income tax effects of the Tax Cuts and Jobs Act of 2017 (the "Tax Act") on items within AOCI to retained earnings. The guidance is 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.

**2. Discontinued Operations**

On June 29, 2018, the Company completed the sale of the EES Business to Webasto. In accordance with the terms of the Purchase Agreement, as amended by a Side Letter Agreement executed at the closing, the Company received cash consideration of $31,994,000 upon closing, which resulted in a gain of $11,420,000 which has been recorded in "Gain on sale of business, net of tax" in the consolidated statements of operations. During the three-months ended October 27, 2018, the Company recorded a reduction to the gain resulting from a working capital adjustment of $504,000. In addition, the Company is in the process of submitting a Webasto working capital dispute in the amount of $1,085,000 to an independent accounting firm for resolution pursuant to the terms of the Purchase Agreement. No amounts have been recorded in the consolidated financial statements related to the additional working capital dispute as Company has assessed the likelihood of a loss to be less than probable.

The Company is entitled to receive additional cash consideration of $6,500,000 (the "Holdback") upon tendering consents to assignment of two remaining customer contracts to Webasto. The Holdback was not recorded in the Company's consolidated financial statements as the amount was not realized or realizable as of October 27, 2018. The Company's satisfaction of the requirements for the payment of the Holdback is currently in dispute.

During the three months ended October 27, 2018, Webasto filed a recall report with the National Highway Traffic Safety Administration that named certain of the Company's EES products as subject to the recall. The Company is continuing to assess the facts giving rise to the recall. Under the terms of the Purchase Agreement, the Company may be responsible for certain costs of such recall of named products the Company manufactured, sold or serviced prior to the closing of the sale of the EES Business.

Concurrent with the execution of the Purchase Agreement, the Company entered into a transition services agreement (the "TSA") to provide certain general and administrative services to Webasto for a defined period. Income from performing services under the TSA income of $1,221,000 and $1,620,000 has been recorded in "Other income, net" in the consolidated statements of operations for three and six months ended October 27, 2018, respectively.

The Company determined that the EES Business met the criteria for classification as an asset held for sale as of April 30, 2018 and represents a strategic shift in in the Company’s 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 (in thousands).

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | October 27, 2018 | October 28, 2017 | October 27, 2018 | October 28, 2017 |
| Net sales | $ — | $ 9,965 | $ 4,256 | $ 17,575 |
| Cost of sales | 748 | 8,293 | 5,026 | 14,803 |
| Gross margin | (748) | 1,672 | (770) | 2,772 |
| Selling, general and administrative | 50 | 1,696 | 1,503 | 3,740 |
| Research and development | (25) | 429 | 1,040 | 1,348 |
| Other income, net | — | — | 1 | — |
| Loss from discontinued operations before income taxes | (773) | (453) | (3,312) | (2,316) |
| Benefit for income taxes | (174) | (420) | (863) | (795) |
| Net loss from discontinued operations | $ (599) | $ (33) | $ (2,449) | $ (1,521) |
| (Loss) gain on sale of business, net of tax (benefit) expense of $(114) and $2,463 for the three and six months ended October 27, 2018, respectively | (391) | — | 8,452 | — |
| Net income (loss) from discontinued operations | $ (990) | $ (33) | $ 6,003 | $ (1,521) |

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

| | April 30, 2018 |
|---|---|
| **Carrying amount of assets classified as discontinued operations** | |
| Current assets: | |
| Accounts receivable, net of allowance for doubtful accounts of $139 at April 30, 2018 | $ 6,889 |
| Inventories, net | 15,494 |
| Prepaid expenses and other current assets | 185 |
| Property and equipment, net | 3,100 |
| Total current assets classified as discontinued operations | 25,668 |
| Total assets classified as discontinued operations | $ 25,668 |
| **Carrying amount of liabilities classified as discontinued operations** | |
| Current liabilities: | |
| Accounts payable | $ 5,121 |
| Wages and related accruals | 1,946 |
| Customer advances | 1,028 |
| Other current liabilities | 1,199 |
| Total current liabilities | 9,294 |
| Total liabilities classified as discontinued operations | $ 9,294 |

**3. Investments**

Investments consist of the following (in thousands):

| | October 27, 2018 | April 30, 2018 |
|---|---|---|
| Short-term investments: | | |
| Held-to-maturity securities: | | |
| Municipal securities | $ 14,326 | $ 35,344 |
| U.S. government securities | 36,948 | 31,620 |
| Corporate bonds | 82,262 | 46,685 |
| Certificates of deposit | 5,000 | — |
| Total held-to-maturity and short-term investments | $ 138,536 | $ 113,649 |
| Long-term investments: | | |
| Held-to-maturity securities: | | |
| Municipal securities | $ 993 | $ 2,046 |
| U.S. government securities | 26,746 | 27,356 |
| Corporate bonds | 2,720 | 9,112 |
| Total held-to-maturity investments | 30,459 | 38,514 |
| Available-for-sale securities: | | |
| Auction rate securities | — | 2,142 |
| Total available-for-sale investments | — | 2,142 |
| Total long-term investments | $ 30,459 | $ 40,656 |

**Held-To-Maturity Securities**

As of October 27, 2018 and April 30, 2018, the balance of held-to-maturity securities consisted of state and local government municipal securities, U.S. treasury securities, U.S. government-guaranteed agency securities, U.S. government-sponsored agency debt securities, highly rated corporate bonds, and certificates of deposit. Interest earned from these investments is recorded in interest income.

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of October 27, 2018 were as follows (in thousands):

| | October 27, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Municipal securities | $ 15,319 | $ — | $ (12) | $ 15,307 |
| U.S. government securities | 63,694 | 3 | (271) | 63,426 |
| Corporate bonds | 84,982 | 2 | (76) | 84,908 |
| Certificates of deposit | 5,000 | — | — | 5,000 |
| Total held-to-maturity investments | $ 168,995 | $ 5 | $ (359) | $ 168,641 |

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of April 30, 2018 were as follows (in thousands):

| | April 30, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Municipal securities | $ 37,390 | $ 9 | $ (36) | $ 37,363 |
| U.S. government securities | 58,976 | — | (367) | 58,609 |
| Corporate bonds | 55,797 | 2 | (71) | 55,728 |
| Certificates of deposit | — | — | — | — |
| Total held-to-maturity investments | $ 152,163 | $ 11 | $ (474) | $ 151,700 |

The amortized cost and fair value of the held-to-maturity securities by contractual maturity at October 27, 2018 were as follows (in thousands):

| | Cost | Fair Value |
|---|---|---|
| Due within one year | $ 138,536 | $ 138,270 |
| Due after one year through five years | 30,459 | 30,371 |
| Total | $ 168,995 | $ 168,641 |

**Available-For-Sale Securities**

**Auction Rate Securities**

As of April 30, 2018, the 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 predetermined 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 three months ended July 28, 2018, the remaining investment grade auction rate municipal bonds were redeemed at par value.

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the auction rate securities as of April 30, 2018, were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Auction rate securities | $ 2,250 | $ — | $ (108) | $ 2,142 |
| Total available-for-sale investments | $ 2,250 | $ — | $ (108) | $ 2,142 |

**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 did not have any financial assets measured at fair value on a recurring basis at October 27, 2018 as the Company's remaining auction rate securities were redeemed during the three months ended July 28, 2018 at par value. The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis that used significant unobservable inputs (Level 3) (in thousands):

| Description | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) |
|---|---|
| Balance at May 1, 2018 | $ 2,142 |
| Transfers to Level 3 | — |
| Total gains (realized or unrealized) | |
| Included in earnings | — |
| Included in other comprehensive income | 108 |
| Settlements | (2,250) |
| Balance at October 27, 2018 | $ — |
| 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 October 27, 2018 | $ — |

The auction rate securities were valued using a discounted cash flow model. The analysis considered, 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.

**5. Inventories, net**

Inventories consist of the following (in thousands):

| | October 27, 2018 | April 30, 2018 |
|---|---|---|
| Raw materials | $ 14,271 | $ 12,020 |
| Work in process | 12,311 | 14,780 |
| Finished goods | 24,241 | 14,578 |
| Inventories, gross | 50,823 | 41,378 |
| Reserve for inventory excess and obsolescence | (4,727) | (3,953) |
| Inventories, net | $ 46,096 | $ 37,425 |

### 6. Equity Method Investments

In December 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 for as an equity method investment. For the three and six months ended October 27, 2018, the Company recorded 5% of the net loss of HAPSMobile, or $752,000 and $1,354,000, respectively, in "Equity method investment activity, net of tax" in the unaudited consolidated statement of operations. At October 27, 2018, the carrying value of the investment in HAPSMobile was $625,000 and was recorded in "Other assets."

### 7. Warranty Reserves

The Company accrues an estimate of its exposure to warranty claims based upon both current and historical product sales data and warranty costs incurred. The warranty reserve is included in other current liabilities. The related expense is included in cost of sales. Warranty reserve activity is summarized as follows for the three and six months ended October 27, 2018 and October 28, 2017, respectively (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | October 27, 2018 | October 28, 2017 | October 27, 2018 | October 28, 2017 |
| Beginning balance | $ 3,138 | $ 1,624 | $ 2,090 | $ 1,947 |
| Warranty expense | (249) | 632 | 361 | 911 |
| Changes in estimates related to pre-existing warranties | (219) | — | 493 | — |
| Warranty costs settled | (239) | (326) | (513) | (928) |
| Ending balance | $ 2,431 | $ 1,930 | $ 2,431 | $ 1,930 |

During the six months ended October 27, 2018, the Company revised its estimates based on the results of additional engineering studies and recorded incremental warranty reserve charges totaling $519,000 related to the estimated costs to repair a component of certain small UAS that were delivered in prior periods. At October 27, 2018, the total remaining warranty reserve related to the estimated costs to repair the impacted UAS was $493,000. As of October 27, 2018 a total of $26,000 of costs related to this warranty have been incurred.

### 8. Intangibles

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

| | October 27, 2018 | April 30, 2018 |
|---|---|---|
| | (In thousands) | |
| Licenses | $ 1,006 | $ 818 |
| Customer relationships | 733 | 733 |
| Trademarks and tradenames | 28 | 28 |
| Other | 3 | 3 |
| Intangibles, gross | 1,770 | 1,582 |
| Less accumulated amortization | (1,104) | (954) |
| Intangibles, net | $ 666 | $ 628 |

The customer relationships, trademarks and tradenames, and other intangible assets were recognized in conjunction with the Company's acquisition of a controlling interest in Altoy on February 1, 2017.

**9. Accumulated Other Comprehensive Income (Loss) and Reclassifications Adjustments**

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

| | Available-for-Sale Securities | Foreign Currency Translation Adjustments | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|
| Balance, net of $76 of taxes, as of April 30, 2018 | $ (57) | $ 36 | $ (21) |
| Reclassifications out of accumulated other comprehensive loss, net of taxes | — | — | — |
| Change in foreign currency translation adjustments, net of $0 taxes | — | (31) | (31) |
| Unrealized gains, net of $51 of taxes | 57 | — | 57 |
| Balance, net of $0 of taxes, as of October 27, 2018 | $ — | $ 5 | $ 5 |

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

Customer-funded R&D costs are incurred pursuant to contracts (revenue arrangements) to perform R&D activities according to customer specifications. These costs are direct contract costs and are expensed to cost of sales as costs are incurred. Revenue from customer-funded R&D contracts are recognized in accordance with Topic 606 over time as costs are incurred. Revenue from customer-funded R&D was approximately $18,790,000 and $35,907,000 for the three and six months ended October 27, 2018, respectively. Revenue from customer-funded R&D was approximately $11,864,000 and $20,662,000 for the three and six months ended October 28, 2017, respectively.

**11. Long-Term Incentive Awards**

During the three months ended July 28, 2018, the Company granted awards under its amended and restated 2006 Equity Incentive Plan (the "Restated 2006 Plan") to key employees ("Fiscal 2019 LTIP"). Awards under the Fiscal 2019 LTIP consist of: (i) time-based restricted stock awards which vest in equal tranches in July 2019, July 2020 and July 2021, 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, 2021. 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. As of October 27, 2018, the Company recorded $255,000 of compensation expense related to the Fiscal 2019 LTIP. At October 27, 2018, the maximum compensation expense that may be recorded for the performance-based portion of the Fiscal 2019 LTIP is $3,733,000.

During the three months ended July 29, 2017, the Company granted awards under 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 July 2020, 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, 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. As of October 27, 2018, the Company recorded $603,000 of compensation expense related to the Fiscal 2018 LTIP. At October 27, 2018, the maximum compensation expense that may be recorded for the performance-based portion of the Fiscal 2018 LTIP is $2,850,000.

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. As of October 27, 2018, the Company recorded $289,000 of compensation expense related to the Fiscal 2017 LTIP. At October 27, 2018, the maximum compensation expense that may be recorded for the performance-based portion of the Fiscal 2017 LTIP is $2,630,000.

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.

**12. Income Taxes**

On December 22, 2017, the Tax Act was signed into law, which resulted in 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, a deduction for certain Foreign Derived Intangible Income ("FDII"), and limitation on the deductibility of certain executive compensation.

In accordance with 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 was blended in fiscal 2018, resulting in a statutory federal rate of approximately 30.4% (8 months at 35% and 4 months at 21%), and 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 and recorded a one-time deferred tax expense of approximately $3,300,000 during the fiscal 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 $3,300,000 expense for the one-time deferred tax remeasurement is a provisional estimate of the impact of the Tax Act. In addition, for the year ending April 30, 2019 the Company has estimated that the FDII deduction will benefit the Company's full year estimated effective tax rate by approximately 2% and 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 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.

For the three and six months ended October 27, 2018, the Company recorded a provision for income taxes of $1,211,000 and $3,778,000, respectively, yielding effective tax rates of 13.5% and 11.6%, respectively. For the three and six months ended October 28, 2017, the Company recorded a provision for income taxes of $3,358,000 and $137,000, respectively, yielding effective tax rates of 30.8% and 4.2%, respectively. The variance from statutory rates for the three and six months ended October 27, 2018 was primarily due to federal R&D credits and the recording of discrete excess tax benefits of $357,000 and $1,507,000, respectively, resulting from the vesting of restricted stock awards and exercises of stock options. The variance from statutory rates for the three and six months ended October 28, 2017 was primarily due to federal R&D credits and the recording of discrete excess tax benefits of $376,000 and $1,401,000 resulting from the vesting of restricted stock awards and exercises of stock options.

**13. Share Repurchase**

In September 2015, the Company's Board of Directors authorized a program to repurchase up to $25,000,000 of the Company's common stock with no specified termination date for the program. No shares were repurchased under the program during the three and six months ended October 27, 2018. As of October 27, 2018 and April 30, 2018, approximately $21.2 million remained authorized for future repurchases under this program.

**14. Related Party Transactions**

Related party transactions are defined as transactions between the Company and entities either controlled by the Company or that the Company can significantly influence. Although SoftBank has a controlling interest in HAPSMobile, the Company determined that it has the ability to exercise significant influence over HAPSMobile. As such, HAPSMobile and SoftBank are considered related parties of the Company. 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 $76,589,000, 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 $12,832,000 and $24,395,000 for the three and six months ended October 27, 2018, respectively. The Company recorded revenue under the DDA and preliminary design agreements between the Company and SoftBank of $7,071,000 and $9,622,000 for the three and six months ended October 28, 2017, respectively. At October 27, 2018 and April 30, 2018, the Company had unbilled related party receivables from HAPSMobile of $7,764,000 and $3,145,000 recorded in "Unbilled receivables and retentions" on the consolidated balance sheets, respectively. During the year ended April 30, 2018, the Company purchased a 5% stake in accordance with the JVA. Refer to Note 6—Equity Method Investments for further details.

**15. Legal Settlements**

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 proceeds of the settlement were received during the three months ended July 28, 2018 and have been recorded in "Other income, net" on the consolidated statements of operations.

## 16. Impact of Adoption of New Accounting Standards

During the three months ended July 28, 2018, the Company adopted ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). The impact to the Company's unaudited balance sheet as a result of adopting the standard was as follows (in thousands):

| | April 30, 2018 As Reported | Effect of the Adoption of ASC Topic 606 | April 30, 2018 As Adjusted |
|---|---|---|---|
| **Assets** | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 143,517 | $ — | $ 143,517 |
| Short-term investments | 113,649 | — | 113,649 |
| Accounts receivable, net of allowance for doubtful accounts of $1,080 at April 30, 2018 | 56,813 | — | 56,813 |
| Unbilled receivables and retentions (inclusive of related party unbilled receivables of $3,145 at April 30, 2018) | 13,076 | 3,796 | 16,872 |
| Inventories, net | 38,640 | (1,215) | 37,425 |
| Prepaid expenses and other current assets | 5,103 | — | 5,103 |
| Current assets of discontinued operations | 28,349 | (2,681) | 25,668 |
| Total current assets | 399,147 | (100) | 399,047 |
| Long-term investments | 40,656 | — | 40,656 |
| Property and equipment, net | 19,219 | — | 19,219 |
| Deferred income taxes | 11,168 | 326 | 11,494 |
| Other assets | 2,721 | 281 | 3,002 |
| Total assets | $ 472,911 | $ 507 | $ 473,418 |
| **Liabilities and stockholders' equity** | | | |
| Current liabilities: | | | |
| Accounts payable | $ 21,340 | $ — | $ 21,340 |
| Wages and related accruals | 16,851 | — | 16,851 |
| Income taxes payable | 4,085 | — | 4,085 |
| Customer advances | 2,145 | 1,419 | 3,564 |
| Other current liabilities | 6,892 | 62 | 6,954 |
| Current liabilities of discontinued operations | 9,184 | 110 | 9,294 |
| Total current liabilities | 60,497 | 1,591 | 62,088 |
| Deferred rent | 1,536 | — | 1,536 |
| Other non-current liabilities | 622 | — | 622 |
| Deferred tax liability | 67 | — | 67 |
| Liability for uncertain tax positions | 49 | — | 49 |
| Commitments and contingencies | | | |
| Stockholders' equity: | | | |
| Preferred stock, $0.0001 par value: | | | |
| Authorized shares—10,000,000; none issued or outstanding at April 30, 2018 | — | — | — |
| Common stock, $0.0001 par value: | | | |
| Authorized shares—100,000,000 | | | |
| Issued and outstanding shares—23,908,736 at April 30, 2018 | 2 | — | 2 |
| Additional paid-in capital | 170,139 | — | 170,139 |
| Accumulated other comprehensive loss | (21) | — | (21) |
| Retained earnings | 239,997 | (1,084) | 238,913 |
| Total AeroVironment stockholders' equity | 410,117 | (1,084) | 409,033 |
| Noncontrolling interest | 23 | — | 23 |
| Total equity | 410,140 | (1,084) | 409,056 |
| Total liabilities and stockholders' equity | $ 472,911 | $ 507 | $ 473,418 |

The tables below presents the impact of adoption on the Company's unaudited statement of operations for the three and six months ended October 27, 2018 (in thousands except share and per share data).

| | Three Months Ended October 28, 2017 As Reported | Effect of the Adoption of ASC Topic 606 | Three Months Ended October 28, 2017 As Adjusted |
|---|---|---|---|
| Revenue: | | | |
| Product sales | $ 43,675 | $ 4,745 | $ 48,420 |
| Contract services (inclusive of related party revenue of $7,071 for the three months ended October 28, 2017, respectively) | 20,313 | (2,932) | 17,381 |
| | 63,988 | 1,813 | 65,801 |
| Cost of sales: | | | |
| Product sales | 23,194 | 2,002 | 25,196 |
| Contract services | 12,101 | (1,639) | 10,462 |
| | 35,295 | 363 | 35,658 |
| Gross margin: | | | |
| Product sales | 20,481 | 2,743 | 23,224 |
| Contract services | 8,212 | (1,293) | 6,919 |
| | 28,693 | 1,450 | 30,143 |
| Selling, general and administrative | 12,768 | — | 12,768 |
| Research and development | 6,844 | — | 6,844 |
| Income from continuing operations | 9,081 | 1,450 | 10,531 |
| Other income (expense): | | | |
| Interest income, net | 432 | — | 432 |
| Other (expense), net | (55) | — | (55) |
| Income from continuing operations before income taxes | 9,458 | 1,450 | 10,908 |
| Provision for income taxes | 2,975 | 383 | 3,358 |
| Equity method investment activity, net of tax | — | — | — |
| Net income from continuing operations | 6,483 | 1,067 | $ 7,550 |
| Discontinued operations: | | | |
| Gain on sale of business, net of tax expense of $0 for the three months ended October 28, 2017 | — | — | — |
| Income (Loss) from discontinued operations, net of tax | 329 | (362) | (33) |
| Net income (loss) from discontinued operations | 329 | (362) | (33) |
| Net income | 6,812 | 705 | 7,517 |
| Net loss attributable to noncontrolling interest | 206 | — | 206 |
| Net income attributable to AeroVironment | $ 7,018 | $ 705 | $ 7,723 |
| Net income (loss) per share attributable to AeroVironment—Basic | | | |
| Continuing operations | $ 0.29 | $ 0.05 | $ 0.33 |
| Discontinued operations | 0.01 | (0.02) | — |
| Net income per share attributable to AeroVironment—Basic | $ 0.30 | $ 0.03 | $ 0.33 |
| Net income (loss) per share attributable to AeroVironment—Diluted | | | |
| Continuing operations | $ 0.28 | $ 0.05 | $ 0.32 |
| Discontinued operations | 0.01 | (0.02) | — |
| Net income per share attributable to AeroVironment—Diluted | $ 0.29 | $ 0.03 | $ 0.32 |
| Weighted-average shares outstanding: | | | |
| Basic | 23,477,914 | 23,477,914 | 23,477,914 |
| Diluted | 23,832,959 | 23,832,959 | 23,832,959 |

| | Six Months Ended October 28, 2017 As Reported | Effect of the Adoption of ASC Topic 606 | Six Months Ended October 28, 2017 As Adjusted |
|---|---|---|---|
| Revenue: | | | |
| Product sales | $ 67,773 | $ (573) | $ 67,200 |
| Contract services (inclusive of related party revenue of $9,622 for the six months ended October 28, 2017, respectively) | 32,465 | 497 | 32,962 |
| | 100,238 | (76) | 100,162 |
| Cost of sales: | | | |
| Product sales | 41,978 | (810) | 41,168 |
| Contract services | 19,472 | 681 | 20,153 |
| | 61,450 | (129) | 61,321 |
| Gross margin: | | | |
| Product sales | 25,795 | 237 | 26,032 |
| Contract services | 12,993 | (184) | 12,809 |
| | 38,788 | 53 | 38,841 |
| Selling, general and administrative | 24,055 | — | 24,055 |
| Research and development | 12,386 | — | 12,386 |
| Income from continuing operations | 2,347 | 53 | 2,400 |
| Other income (expense): | | | |
| Interest income, net | 944 | — | 944 |
| Other expense, net | (51) | — | (51) |
| Income from continuing operations before income taxes | 3,240 | 53 | 3,293 |
| Provision (benefit) for income taxes | 144 | (7) | 137 |
| Equity method investment activity, net of tax | — | — | — |
| Net income from continuing operations | 3,096 | 60 | $ 3,156 |
| Discontinued operations: | | | |
| Gain on sale of business, net of tax expense of $0 for the six months ended October 28, 2017 | — | — | — |
| Loss from discontinued operations, net of tax | (750) | (771) | (1,521) |
| Net loss from discontinued operations | (750) | (771) | (1,521) |
| Net income (loss) | 2,346 | (711) | 1,635 |
| Net loss attributable to noncontrolling interest | 229 | — | 229 |
| Net income (loss) attributable to AeroVironment | $ 2,575 | $ (711) | $ 1,864 |
| Net income (loss) per share attributable to AeroVironment—Basic | | | |
| Continuing operations | $ 0.14 | $ 0.00 | $ 0.14 |
| Discontinued operations | (0.03) | (0.03) | (0.06) |
| Net income (loss) per share attributable to AeroVironment—Basic | $ 0.11 | $ (0.03) | $ 0.08 |
| Net income (loss) per share attributable to AeroVironment—Diluted | | | |
| Continuing operations | $ 0.14 | $ 0.00 | $ 0.14 |
| Discontinued operations | (0.03) | (0.03) | (0.06) |
| Net income (loss) per share attributable to AeroVironment—Diluted | $ 0.11 | $ (0.03) | $ 0.08 |
| Weighted-average shares outstanding: | | | |
| Basic | 23,407,500 | 23,407,500 | 23,407,500 |
| Diluted | 23,715,997 | 23,715,997 | 23,715,997 |

The tables below presents the impact of adoption on the Company's unaudited statement of comprehensive loss for the three and six months October 28, 2017 (in thousands).

| | Three Months Ended October 28, 2017 As Reported | Effect of the Adoption of ASC Topic 606 | Three Months Ended October 28, 2017 As Adjusted |
|---|---|---|---|
| Net income | $ 6,812 | $ 705 | $ 7,517 |
| Other comprehensive income: | | | |
| Change in foreign currency translation adjustments | — | — | — |
| Unrealized gain on investments, net of deferred tax expense of $17 for the three months ended October 28, 2017, respectively | 26 | — | 26 |
| Total comprehensive income | 6,838 | 705 | $ 7,543 |
| Net loss attributable to noncontrolling interest | 206 | — | 206 |
| Comprehensive income attributable to AeroVironment | $ 7,044 | $ 705 | $ 7,749 |

| | Six Months Ended October 28, 2017 As Reported | Effect of the Adoption of ASC Topic 606 | Six Months Ended October 28, 2017 As Adjusted |
|---|---|---|---|
| Net income | $ 2,346 | $ (711) | $ 1,635 |
| Other comprehensive income: | | | |
| Change in foreign currency translation adjustments | — | — | — |
| Unrealized gain on investments, net of deferred tax expense of $19 for the six months ended October 28, 2017, respectively | 29 | — | 29 |
| Total comprehensive income | 2,375 | (711) | $ 1,664 |
| Net loss attributable to noncontrolling interest | 229 | — | 229 |
| Comprehensive income attributable to AeroVironment | $ 2,604 | $ (711) | $ 1,893 |

The table below presents the impact of adoption on the Company's unaudited statement of cash flows (in thousands).

| | Six Months Ended October 28, 2017 As Reported | Effect of the Adoption of ASC Topic 606 | Six Months Ended October 28, 2017 As Adjusted |
|---|---|---|---|
| **Operating activities** | | | |
| Net income | $ 2,346 | $ (711) | $ 1,635 |
| Gain on sale of business, net of tax | — | — | — |
| Loss from discontinued operations, net of tax | 750 | 771 | 1,521 |
| Net income from continuing operations | 3,096 | 60 | 3,156 |
| Adjustments to reconcile net loss to cash provided by operating activities: | | | |
| Depreciation and amortization | 2,784 | — | 2,784 |
| Loss from equity method investments | — | — | — |
| Impairment of long-lived assets | 255 | — | 255 |
| Provision for doubtful accounts | 935 | — | 935 |
| Impairment of intangible assets and goodwill | 1,021 | — | 1,021 |
| Gains on foreign currency transactions | (108) | — | (108) |
| Deferred income taxes | (1,094) | — | (1,094) |
| Stock-based compensation | 2,535 | — | 2,535 |
| Loss on disposition of property and equipment | 15 | — | 15 |
| Amortization of held-to-maturity investments | 897 | — | 897 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | 39,861 | — | 39,861 |
| Unbilled receivables and retentions | 625 | (25) | 600 |
| Inventories | (13,621) | (151) | (13,772) |
| Income tax receivable | — | (307) | (307) |
| Prepaid expenses and other assets | 413 | — | 413 |
| Accounts payable | (2,972) | — | (2,972) |
| Other liabilities | (4,348) | 123 | (4,225) |
| Net cash provided by (used in) operating activities of continuing operations | 30,294 | (300) | 29,994 |
| **Investing activities** | | | |
| Acquisition of property and equipment | (5,455) | — | (5,455) |
| Proceeds from sale of business | — | — | — |
| Redemptions of held-to-maturity investments | 105,758 | — | 105,758 |
| Purchases of held-to-maturity investments | (88,763) | — | (88,763) |
| Redemptions of available-for-sale investments | 450 | — | 450 |
| Net cash provided by investing activities from continuing operations | 11,990 | — | 11,990 |
| **Financing activities** | | | |
| Principal payments of capital lease obligations | (173) | — | (173) |
| Tax withholding payment related to net settlement of equity awards | (313) | — | (313) |
| Exercise of stock options | 2,164 | — | 2,164 |
| Net cash provided by financing activities from continuing operations | 1,678 | — | 1,678 |
| **Discontinued operations** | | | |
| Operating activities of discontinued operations | (6,175) | 300 | (5,875) |
| Investing activities of discontinued operations | (582) | — | (582) |
| Financing activities of discontinued operations | — | — | — |
| Net cash used in discontinued operations | (6,757) | 300 | (6,457) |
| Net increase in cash and cash equivalents | 37,205 | — | 37,205 |
| Cash and cash equivalents at beginning of period | 79,904 | — | 79,904 |
| Cash and cash equivalents at end of period | $ 117,109 | $ — | $ 117,109 |
| **Supplemental disclosures of cash flow information** | | | |
| Cash paid, net during the period for: | | | |
| Income taxes | $ 1,803 | — | $ 1,803 |
| **Non-cash activities** | | | |
| Unrealized gain on investments, net of deferred tax expense of $19 | $ 29 | — | $ 29 |
| Reclassification from share-based liability compensation to equity | $ 384 | — | $ 384 |
| Change in foreign currency translation adjustments | $ — | — | $ — |
| Acquisitions of property and equipment included in accounts payable | $ 888 | — | $ 888 |

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

The following is a discussion and analysis of our financial condition and the results of operations as of and for the periods presented below. The following discussion and analysis should be read in conjunction with the "Consolidated Financial Statements" and notes thereto included elsewhere in this Quarterly Report on Form 10-Q. This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "projects," "should," "will," "would" or similar expressions. Such forward-looking statements are based on current expectations, estimates and projections about our industry, our management's beliefs and assumptions made by our management. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended April 30, 2018, as updated by our subsequent filings under the Securities and Exchange Act of 1934, as amended ("the Exchange Act").

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

**Critical Accounting Policies and Estimates**

The following should be read in conjunction with the critical accounting estimates presented in our Annual Report on Form 10-K for the fiscal year ended April 30, 2018.

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, warranty liabilities, self-insured liabilities, accounting for stock-based awards, and income taxes. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions.

In the first quarter of our fiscal 2019, we adopted ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606), using the full retrospective method. Topic 606 requires revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which we expect to be entitled in exchange for those goods or services.

Revenue for small unmanned aircraft systems ("UAS") product contracts with both the U.S. government and foreign government's under the new standard revenue will be recognized at the point in time when the transfer of control passes to the customer, which is generally when title and risk of loss transfer. Revenue for Tactical Missile Systems ("TMS") contracts will now be recognized under the new standard over time as costs are incurred. Under previous U.S. generally accepted accounting principles (U.S. GAAP), revenue was generally recognized when deliveries of the related products were made. The new standard accelerates the timing of when the revenue is recognized, however, it does not change the total amount of revenue recognized on these contracts. The new standard does not affect revenue recognition for our Customer-Funded Research and Development ("R&D") contracts. We continue to recognize revenue for these contracts over time as costs are incurred.

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 estimate of completion for all types of contracts are recognized on a cumulative catch-up basis in the period in which the revisions are made. During the three and six months ended October 27, 2018 and October 28, 2017, changes in accounting estimates on contracts recognized over time are presented below.

For the three months ended October 27, 2018 and October 28, 2017, favorable and unfavorable cumulative catch-up adjustments included in revenue were as follows (in thousands):

| | Three Months Ended | |
|---|---|---|
| | October 27, 2018 | October 28, 2017 |
| Gross favorable adjustments | $ 358 | $ 2,042 |
| Gross unfavorable adjustments | (324) | (1,686) |
| Net favorable adjustments | $ 34 | $ 356 |

For the three months ended October 27, 2018, favorable cumulative catch-up adjustments of $0.4 million were primarily due to final cost adjustments on 16 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 24 contracts, which individually were not material.

For the three months ended October 28, 2017, favorable cumulative catch-up adjustments of $2.0 million were primarily due to final cost adjustments on three contracts, which individually were not material. For the same period, unfavorable cumulative catch-up adjustments of $1.7 million were primarily related to higher than expected costs on five contracts, which individually were not material.

For the six months ended October 28, 2017 and October 28, 2017, favorable and unfavorable cumulative catch-up adjustments included in cost of sales were as follows (in thousands):

| | Six Months Ended | |
|---|---|---|
| | October 27, 2018 | October 28, 2017 |
| Gross favorable adjustments | $ 622 | $ 724 |
| Gross unfavorable adjustments | (465) | (1,498) |
| Net favorable adjustments | $ 157 | $ (774) |

For the six months ended October 27, 2018, favorable cumulative catch-up adjustments of $0.6 million were primarily due to final cost adjustments on nine contracts, which individually were not material. For the same period, unfavorable cumulative catch-up adjustments of $0.5 million were primarily related to higher than expected costs on 18 contracts, which individually were not material.

For the six months ended October 28, 2017, favorable cumulative catch-up adjustments of $0.7 million were primarily due to final cost adjustments on seven contracts, which individually were not material. For the same period, unfavorable cumulative catch-up adjustments of $1.5 million were primarily related to higher than expected costs on six contracts, which individually were not material.

**Fiscal Periods**

Due to our fixed year end date of April 30, our first and fourth quarters each consist of approximately 13 weeks. The second and third quarters each consist of exactly 13 weeks. Our first three quarters end on a Saturday. Our 2019 fiscal year ends on April 30, 2019 and our fiscal quarters end on July 28, 2018, October 27, 2018 and January 26, 2019, respectively.

**Results of Operations**

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

***Three Months Ended October 27, 2018 Compared to Three Months Ended October 28, 2017***

| | Three Months Ended | |
|---|---|---|
| | October 27, 2018 | October 28, 2017 |
| Revenue | $ 72,979 | $ 65,801 |
| Cost of sales | 44,580 | 35,658 |
| Gross margin | 28,399 | 30,143 |
| Selling, general and administrative | 13,646 | 12,768 |
| Research and development | 8,109 | 6,844 |
| Income from operations | 6,644 | 10,531 |
| Other income (expense): | | |
| Interest income, net | 1,068 | 432 |
| Other expense, net | 1,291 | (55) |
| Income from continuing operations before income taxes | 9,003 | 10,908 |
| Provision for income taxes | 1,211 | 3,358 |
| Equity method investment activity, net of tax | (752) | — |
| Net income from continuing operations | $ 7,040 | $ 7,550 |

***Revenue.*** Revenue for the three months ended October 27, 2018 was $73.0 million, as compared to $65.8 million for the three months ended October 28, 2017, representing an increase of $7.2 million, or 11%. The increase in revenue was due to an increase in service revenue of $8.5 million, partially offset by a decrease in product deliveries of $1.3 million. The increase in service revenue was primarily due to an increase in customer-funded R&D primarily associated with the HAPSMobile design and development agreement ("DDA") and an increase in services for TMS and TMS 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 TMS.

***Cost of Sales.*** Cost of sales for the three months ended October 27, 2018 was $44.6 million, as compared to $35.7 million for the three months ended October 28, 2017, representing an increase of $8.9 million, or 25%. The increase in cost of sales was a result of an increase in service costs of sales of $7.5 million and an increase in product cost of sales of $1.4 million. The increase in service costs of sales was primarily due to the increase in service revenue and unfavorable mix. The increase in product costs was primarily due to an unfavorable product mix. As a percentage of revenue, cost of sales increased from 54% to 61%, primarily due to an increase in the proportion of service revenue to total revenue and an unfavorable mix.

***Gross Margin.*** Gross margin for the three months ended October 27, 2018 was $28.4 million, as compared to $30.1 million for the three months ended October 28, 2017, representing a decrease of $1.7 million, or 6%. The decrease in gross margin was primarily due to a decrease in product margin of $2.7 million, partially offset by an increase in service margin of $1.0 million. The decrease in product margin was primarily due to an unfavorable product mix and a decrease in product deliveries. The increase in service margin was primarily due to an increase in service revenue, partially offset by an unfavorable mix. As a percentage of revenue, gross margin decreased from 46% to 39%, primarily due to an increase in the proportion of service deliveries to total revenue and an unfavorable mix.

***Selling, General and Administrative.*** Selling, general and administrative ("SG&A") expense for the three months ended October 27, 2018 was $13.6 million, or 19% of revenue, compared to SG&A expense of $12.8 million, or 19% of revenue, for the three months ended October 28, 2017. The increase in SG&A expense was primarily due to an increase in a number of miscellaneous expenses that were not individually significant.

***Research and Development.*** R&D expense for the three months ended October 27, 2018 was $8.1 million, or 11% of revenue, compared to R&D expense of $6.8 million, or 10% of revenue, for the three months ended October 28, 2017. R&D expense increased by $1.3 million, or 18%, for the three months ended October 27, 2018, primarily due to an increase in development activities for certain strategic initiatives.

***Interest Income, net.*** Interest income, net for the three months ended October 27, 2018 was $1.1 million compared to interest income, net of $0.4 million for the three months ended October 28, 2017. The increase in interest income was primarily due to an increase in the interest rates earned on our investment portfolio.

***Other Income, net.*** Other income, net, for the three months ended October 27, 2018 was $1.3 million compared to other expense, net of $0.1 million for the three months ended October 28, 2017. The increase in other income, net was primarily due to income earned under a transition services agreement with the buyer of our former efficient energy systems business segment ("EES Business").

***Provision for Income Taxes.*** Our effective income tax rate was 13.5% for the three months ended October 27, 2018, as compared to 30.8% for the three months ended October 28, 2017. The decrease in effective income tax rate was primarily due to the reduction in the fiscal 2019 federal statutory rate from 35% to 21% resulting from the Tax Cuts and Jobs Act of 2017 (the "Tax Act").

***Equity Method Investment Activity, net of tax.*** Equity method investment activity, net of tax for the three months ended October 27, 2018 was a loss of $0.8 million compared to no equity method investment activity, net of tax activity for the three months ended October 28, 2017. The increase was due to the equity method loss associated with our investment in the HAPSMobile joint venture formed in December 2017.

***Six Months Ended October 27, 2018 Compared to Six Months Ended October 28, 2017***

| | Six Months Ended | |
|---|---|---|
| | October 27, 2018 | October 28, 2017 |
| Revenue | $ 151,022 | $ 100,162 |
| Cost of sales: | 90,034 | 61,321 |
| Gross margin | 60,988 | 38,841 |
| Selling, general and administrative | 25,602 | 24,055 |
| Research and development | 14,544 | 12,386 |
| Income from operations | 20,842 | 2,400 |
| Other income (expense): | | |
| Interest income, net | 1,974 | 944 |
| Other expense, net | 9,679 | (51) |
| Income from continuing operations before income taxes | 32,495 | 3,293 |
| Provision for income taxes | 3,778 | 137 |
| Equity method investment activity, net of tax | (1,354) | — |
| Net income from continuing operations | $ 27,363 | $ 3,156 |

***Revenue.*** Revenue for the six months ended October 27, 2018 was $151.0 million, as compared to $100.2 million for the six months ended October 28, 2017, representing an increase of $50.8 million, or 51%. The increase in revenue was due an increase in product deliveries of $35.1 million and an increase in service revenue of $15.7 million. The increase in product deliveries was primarily due to an increase in product deliveries of small UAS and an increase in product deliveries of TMS. During the six months ended October 27, 2018, we continued to experience expansion in small UAS product deliveries to international customers. The increase in service revenue was primarily due to an increase in customer-funded R&D primarily associated with the HAPSMobile DDA and services for TMS and TMS variant programs, partially offset by decreases in sustainment activities in support of small UAS.

***Cost of Sales.*** Cost of sales for the six months ended October 27, 2018 was $90.0 million, as compared to $61.3 million for the six months ended October 28, 2017, representing an increase of $28.7 million, or 47%. The increase in cost of sales was a result of an increase in product cost of sales of $15.2 million and an increase in service costs of sales of $13.5 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 and unfavorable mix. As a percentage of revenue, cost of sales decreased from 61% to 60%, primarily due to an increase in sales volume, which resulted in an decrease in the per unit fixed manufacturing and engineering overhead support cost.

***Gross Margin.*** Gross margin for the six months ended October 27, 2018 was $61.0 million, as compared to $38.8 million for the six months ended October 28, 2017, representing an increase of $22.2 million, or 57%. The increase in gross margin was primarily due to an increase in product margin of $20.0 million and an increase in service margin of $2.2 million. The increase in product margin was primarily due to an increase in product deliveries. The increase in service margin was primarily due to an increase in service revenue, partially offset by unfavorable mix. As a percentage of revenue, gross margin increased from 39% to 40%, primarily due to an increase in sales volume, which resulted in an decrease in the per unit fixed manufacturing and engineering overhead support cost.

***Selling, General and Administrative.*** Selling, general and administrative (“SG&A”) expense for the six months ended October 27, 2018 was $25.6 million, or 17% of revenue, compared to SG&A expense of $24.1 million, or 24% of revenue, for the six months ended October 28, 2017. The increase in SG&A expense was primarily due to an increase in corporate development expenses primarily related to the sale of our EES business and an increase in employee related costs, partially offset by a decrease in litigation-related expenses and a decrease in bad debt expense.

***Research and Development.*** R&D expense for the six months ended October 27, 2018 was $14.5 million, or 10% of revenue, compared to R&D expense of $12.4 million, or 12% of revenue, for the six months ended October 28, 2017. R&D expense increased by $2.2 million, or 17%, for the six months ended October 27, 2018, primarily due to an increase in development activities for certain strategic initiatives.

***Interest Income, net.*** Interest income, net for the six months ended October 27, 2018 was $2.0 million compared to interest income, net of $0.9 million for the six months ended October 28, 2017. The increase in interest income was primarily due to an increase in the interest rates earned on our investment portfolio.

***Other Income, net.*** Other income, net, for the six months ended October 27, 2018 was $9.7 million compared to other expense, net of $0.1 million for the six months ended October 28, 2017. The increase in other income, net was primarily due to a litigation settlement and income earned under a transition services agreement with the buyer of our former EES Business.

***Provision for Income Taxes.*** Our effective income tax rate was 11.6% for the six months ended October 27, 2018, as compared to 4.2% for the six months ended October 28, 2017. The increase in effective income tax rate was primarily due to an increase in income before income taxes, partially offset by the reduction in the fiscal 2019 federal statutory rate from 35% to 21% resulting from the Tax Act.

***Equity Method Investment Activity, net of tax.*** Equity method investment activity, net of tax for the six months ended October 27, 2018 was a loss of $1.4 million compared to no equity method investment activity, net of tax activity for the six months ended October 28, 2017. The increase was due to the equity method loss associated with our investment in the HAPSMobile joint venture formed in December 2017.

**Backlog**

We define funded backlog as remaining performance obligations under firm orders for which funding is currently appropriated to us under a customer contract. As of October 27, 2018, our funded backlog was approximately $163.9 million.

In addition to our funded backlog, we also had unfunded backlog of $51.9 million as of October 27, 2018. Unfunded backlog does not meet the definition of a performance obligation under ASC Topic 606. We define unfunded backlog as the total remaining potential order amounts under cost reimbursable and fixed price contracts with multiple one-year options, and indefinite delivery, indefinite quantity, or IDIQ contracts. Unfunded backlog does not obligate the U.S. government to purchase goods or services. There can be no assurance that unfunded backlog will result in any orders in any particular period, if at all. Management believes that unfunded backlog does not provide a reliable measure of future estimated revenue under our contracts. Unfunded backlog does not include the remaining potential value associated with a U.S. Army IDIQ-type contract for small UAS because the contract was awarded to seven companies in 2018, including AeroVironment, and we cannot be certain that we will receive 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 or are renewed or new contracts are awarded. A majority of our contracts, specifically our IDIQ contracts, do not currently obligate the U.S. government to purchase any goods or services. Additionally, all U.S. government contracts included in backlog, whether or not they are funded, may be terminated at the convenience of the U.S. government.

**Liquidity and Capital Resources**

We currently have no material cash commitments, except for normal recurring trade payables, accrued expenses and ongoing R&D costs, all of which we anticipate funding through our existing working capital and funds provided by operating activities. The majority of our purchase obligations are pursuant to funded contractual arrangements with our customers. In addition, we 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 and capital expenditure requirements 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 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, enhancing existing products and marketing to stimulate acceptance and adoption of our products and services. Our future capital requirements, to a certain extent, are also subject to general conditions in or affecting the defense and commercial industries and are subject to general economic, political, financial, competitive, legislative and regulatory factors that are beyond our control. To the extent that existing cash, cash equivalents, and cash from operations are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. 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 other expenses incurred during the lead time from contract award until contract deliveries begin.

**Cash Flows**

The following table provides our cash flow data for the six months ended October 27, 2018 and October 28, 2017 (in thousands):

| | Six Months Ended | |
|---|---|---|
| | October 27, 2018 | October 28, 2017 |
| | (Unaudited) | |
| Net cash provided by operating activities | $ 2,657 | $ 29,994 |
| Net cash provided by investing activities | $ 13,736 | $ 11,990 |
| Net cash (used in) provided by financing activities | $ (1,015) | $ 1,678 |

***Cash Provided by Operating Activities.*** Net cash provided by operating activities for the six months ended October 27, 2018 decreased by $27.3 million to $2.7 million, compared to net cash provided by operating activities of $30.0 million for the six months ended October 28, 2017. The decrease in net cash provided by operating activities was primarily due to a decrease in cash as a result of changes in operating assets and liabilities of $50.6 million, largely resulting from increases in unbilled receivables and retentions primarily due to the timing of revenue recognition and billings, partially offset by an increase in net income from continuing operations of $24.2 million.

***Cash Provided by Investing Activities.*** Net cash provided by investing activities increased by $1.7 million to $13.7 million for the six months ended October 27, 2018, compared to net cash provided by investing activities of $12.0 million for the six months ended October 28, 2017. The increase in net cash provided by investing activities was primarily due to proceeds from the sale of our EES Business of $32.0 million and an increase in redemptions of available-for-sale investments of $1.8 million, partially offset by a decrease in net redemptions and purchases of investments of $33.4 million.

***Cash (Used in) Provided by Financing Activities.*** Net cash used in financing activities increased by $2.7 million to $1.0 million for the six months ended October 27, 2018, compared to net cash provided by financing activities of $1.7 million for the six months ended October 28, 2017. The increase in cash used in financing activities was primarily due to a decrease in cash provided from the exercise of employee stock options of $2.1 million.

**Contractual Obligations**

During the three and six months ended October 27, 2018, there were no material changes in our contractual obligations and commercial commitments from those disclosed in our Annual Report on Form 10-K for the fiscal year ended April 30, 2018.

**Off-Balance Sheet Arrangements**

As of October 27, 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.

**New Accounting Standards**

Please refer to Note 1 "Organization and Significant Accounting Policies" to our unaudited consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of new accounting pronouncements and accounting pronouncements adopted during the six months ended October 27, 2018.

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

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

***Interest Rate Risk***

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

***Foreign Currency Exchange Rate Risk***

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

## ITEM 4. CONTROLS AND PROCEDURES

***Controls and Procedures***

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

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

As required by Rule 13a-15(b) under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as of October 27, 2018, the end of the period covered by this Quarterly Report on Form 10-Q.

Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that, as of October 27, 2018, the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective and were operating at a reasonable assurance level.

***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 Rules 13a-15 or 15d-15 under the Exchange Act that occurred during the quarter ended October 27, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act).

## PART II. OTHER INFORMATION

### ITEM 1. 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. Nawabi was subsequently dismissed as an individual defendant for the racial discrimination and wrongful terminations claims. On August 2, 2018, the defendants filed their answer to the complaint and a demurrer seeking dismissal of the whistle blower retaliation claim against Mr. Nawabi. The defendants filed a supplemental brief in support of the demurrer on October 23, 2018 and a supplemental reply in support of the demurrer on November 20, 2018. A hearing is scheduled for December 11, 2018 regarding the demurrer. 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 and will defend ourselves vigorously.

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 1A. RISK FACTORS

Except as set forth below, there have been no material changes to the risk factors disclosed under Part I, Item 1A, "Risk Factors," of our Annual Report on Form 10-K for the fiscal year ended April 30, 2018. Please refer to that section for disclosures regarding the risks and uncertainties related to our business.

***The acquisition of the assets associated with our EES Business by Webasto may disrupt our business.***

On June 1, 2018, we entered into an Asset Purchase Agreement (the "Purchase Agreement") with Webasto Charging Systems, Inc. ("Webasto"), pursuant to which Webasto agreed to acquire certain properties, assets and rights used or previously held for use in connection with our EES Business. On June 29, 2018, we and Webasto entered into a Side Letter Agreement related to the Purchase Agreement (the "Letter Agreement"), pursuant to which we and Webasto agreed that the purchase price to be paid by Webasto to us at the closing of the transactions contemplated by the Purchase Agreement would be reduced by $6.5 million (the "Holdback Amount") at closing, with such balance payable when we tendered certain consents of specified EES Business customers to Webasto. On June 29, 2018, we closed our disposition of the EES Business pursuant to the Purchase Agreement. As of November 21, 2018, we had not yet received the Holdback Amount from Webasto.

While we continue to provide transition services and other support to Webasto in connection with its acquisition of our EES Business, our post-closing activities and obligations under the Purchase Agreement and related transaction agreements 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, in the event that we do not receive the Holdback Amount from Webasto or otherwise incur any further liabilities pursuant to the terms of the Purchase Agreement, our financial condition and results of operations may be negatively affected and the price per share of our common stock could decline.

***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. We also remain responsible for non-warranty costs of any recall of products we manufactured, sold or serviced prior to closing of our transaction with Webasto. In particular, on August 24, 2018, Webasto filed a recall report with the National Highway Traffic Safety Administration that named us as a brand of the affected equipment. To the extent we are obligated under the terms of the Purchase Agreement with Webasto or pursuant to applicable law for all or any portion of the costs incurred in connection with such recall, or any other such recall, our results of operations may be negatively affected.

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 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.

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

### 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 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. No shares were repurchased in the six months ended October 27, 2018. As of October 27, 2018, approximately $21.2 million remained authorized for future repurchases under this program.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

**ITEM 6. EXHIBITS**

| Exhibit Number | Description |
|---|---|
| 3.1(1) | Amended and Restated Certificate of Incorporation of AeroVironment, Inc. |
| 3.2(2) | Third Amended and Restated Bylaws of AeroVironment, Inc. |
| 10.1 | First Amendment to Lease dated October 26, 2018 between AeroVironment, Inc. and Princeton Avenue Holdings, LLC for property located at 14501 Princeton Avenue, Moorpark, California |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32# | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |

(1) Incorporated by reference herein to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed March 9, 2007 (File No. 001-33261).

(2) Incorporated by reference herein to Exhibit 3.3 to the Company's Annual Report on Form 10-K filed July 1, 2015 (File No. 001-33261).

# The information in Exhibit 32 shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or the Exchange Act, or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act (including this report), unless the Company specifically incorporates the foregoing information into those documents by reference.

**SIGNATURES**

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

Date: November 29, 2018

AEROVIRONMENT, INC.

By: /s/ Wahid Nawabi
Wahid Nawabi
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Teresa P. Covington
Teresa P. Covington
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

**Exhibit 10.1**

# FIRST AMENDMENT TO LEASE

THIS FIRST AMENDMENT TO LEASE (this "First Amendment"), dated as of October 26 2018 (the "Effective Date"), is entered into by and between **PRINCETON AVENUE HOLDINGS, LLC,** a California limited liability company ("Landlord"), and **AEROVIRONMENT, INC.,** a Delaware corporation ("Tenant"). Landlord and Tenant may hereinafter be referred to collectively as "the parties".

## RECITALS

A. Landlord and Tenant entered into that certain Lease dated May 28, 2018 (the "Existing Lease") whereby Landlord leased to Tenant and Tenant leased from Landlord premises designated as Suite 200 at 14501 Princeton Avenue, Moorpark, California (the "Building"), consisting of approximately ninety four thousand two hundred eighty (94,280) square feet of floor area (the "Existing Premises").

B. Landlord and Tenant now desire to enter into this First Amendment for purposes of, among other things, expanding the Existing Premises to include Suite 100, consisting of approximately forty nine thousand six hundred ninety three (49,693) square feet of floor area in the Building, as shown on Exhibit A attached hereto and incorporated herein (the "Expansion Premises," and together with the Existing Premises, the "Premises").

## AGREEMENT

NOW THEREFORE, for good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto agree as follows:

1. Incorporation of Recitals and Definitions. Capitalized terms used in this First Amendment not otherwise defined shall have the meanings given such terms in the Existing Lease. The Recitals are hereby incorporated herein by this reference. In the event of any conflicts between the Existing Lease and this First Amendment, the terms of this First Amendment shall control. The Existing Lease as modified by this First Amendment shall be hereinafter referred to as "Lease."

2. Expansion of Premises. In addition to the Existing Premises, effective as of February 1, 2019 (the "Expansion Premises Commencement Date"), and continuing for the duration of the Term, Landlord shall lease to Tenant and Tenant shall lease from Landlord the Expansion Premises upon all of the terms and conditions of the Lease, except as otherwise set forth in this First Amendment. Accordingly, effective on the Expansion Premises Commencement Date, (i) all references to the "Premises" contained in the Lease shall mean and refer to the entirety of the space in the Existing Premises and the Expansion Premises, which together is approximately one hundred forty three thousand nine hundred seventy three (149,973) square feet of floor area (Landlord and Tenant hereby acknowledge and agree that such stated amount of the rentable square footage is not a representation or warranty of the exact number of rentable square feet therein but rather is only a reasonable approximation and that the Base Rent and all other amounts payable in connection with the Lease are not subject to revision whether or not the actual square footage is more or less than such approximation), (ii) all references in the

Lease to "Exhibit A" shall mean and refer to Exhibit A as modified by Exhibit A-1 attached hereto and incorporated herein, (iii) all references in the Lease to the square footage of the Premises shall mean and refer to one hundred forty three thousand nine hundred seventy three (149,973) square feet, and (iv) "Tenant's Pro Rata Share" shall mean and refer to 100%. Notwithstanding the foregoing, the following provisions of the Existing Lease shall not apply to the Expansion Premises: 3(b); 4(a); 4(b) last sentence only; 5(d); 13(e); Exhibits D, D-1, D-2; and 35. At Landlord's election, the parties shall execute a factually correct notice documenting the Expansion Premises Commencement Date in form and substance similar to that attached as Exhibit E to the Existing Lease.

3. As-Is Delivery of Expansion Premises.

(a) Tenant acknowledges that it has inspected the condition of the Expansion Premises, and that it is satisfied therewith and Tenant acknowledges that (i) it accepts the Expansion Premises in its current AS-IS CONDITION WITH ALL FAULTS, (ii) Landlord shall have no obligation to construct any improvements or modifications to the Expansion Premises nor to provide Tenant with any type of tenant improvement allowance except for the Allowance set forth in the Work Letter attached as Exhibit B hereto, and (iii) Landlord has made no representation or warranty regarding the condition of the Expansion Premises or the suitability thereof for Tenant's business.

(b) As required by Section 1938(a) of the California Civil Code, Landlord discloses to Tenant that the Expansion Premises have not undergone inspection by a Certified Access Specialist ("CASp"). As required by Section 1938(e) of the California Civil Code, Landlord also states that: "A Certified Access Specialist (CASp) can inspect the subject premises and determine whether the subject premises comply with all of the applicable construction-related accessibility standards under state law. Although state law does not require a CASp inspection of the subject premises, the commercial property owner or lessor may not prohibit the lessee or tenant from obtaining a CASp inspection of the subject premises for the occupancy or potential occupancy of the lessee or tenant, if requested by the lessee or tenant. The parties shall mutually agree on the arrangements for the time and manner of the CASp inspection, the payment of the fee for the CASp inspection, and the cost of making any repairs necessary to correct violations of construction-related accessibility standards within the premises." As permitted by the quoted language above, it is agreed that: (i) any CASp inspection requested by Tenant shall be requested by Tenant within ten (10) days after the date on which this Lease has been executed by Landlord and Tenant, (ii) Landlord shall be an intended third party beneficiary of the contract under which the inspection is to be performed and the contract shall otherwise comply with the provisions of the Lease applicable to Tenant contracts for construction; (iii) the CASp inspection shall be conducted (A) at Tenant's sole cost and expense, (B) by a CASp approved in advance by Landlord and only after ten (10) days' prior written notice to Landlord of the date of such CASp inspection, (C) between the hours of 9:00 a.m. and 5:00 p.m. on any business day, (D) in a manner reasonably satisfactory to Landlord, and (E) shall be addressed to, and, upon completion, promptly delivered to, Landlord and Tenant; (iv) the information in the inspection shall not be disclosed by Tenant to anyone other than contractors, subcontractors, and consultants of Tenant who have a need to know the information therein and who agree in writing not to further disclose such information; (v) Tenant, at its sole cost and expense, shall be responsible for making any improvements, alterations, modifications and/or repairs to or within the Premises to correct violations of construction-related accessibility standards including, without limitation, any violations disclosed by such CASp inspection; and (vi) if such CASp inspection identifies any improvements, alterations, modifications and/or repairs necessary to correct violations of construction-related accessibility standards relating to those items of the building located outside the Expansion Premises that are Landlord's obligation to repair under this Lease, then Landlord shall perform such improvements, alterations, modifications and/or repairs as and to the extent required by applicable laws to correct such violations, and Tenant shall reimburse Landlord for the cost of such improvements, alterations, modifications and/or repairs within ten (10) business days after Tenant's receipt of an invoice therefor from Landlord.

4. Expansion Premises Tenant Improvements. Tenant shall construct the initial tenant improvements in the Expansion Premises substantially in accordance with the Work Letter attached hereto as Exhibit B. To the extent there are any conflicts between the terms of the Work Letter and the terms of Section 13 of the Existing Lease (re: alterations and improvements), the terms of the Work Letter shall govern Tenant's construction of the initial tenant improvements in the Expansion Premises.

5. Base Rent. Commencing on the Expansion Premises Commencement Date, Base Rent, Tenant's Percentage Share of Operating Expenses and Tenant's Percentage Share of Taxes applicable to the Expansion Premises during the initial Term shall be payable as required under the Existing Lease, except that Tenant shall pay to Landlord upon the Effective Date hereof an amount equal to Thirty Seven Thousand Two Hundred Sixty Nine and 75/100 Dollars ($37,269.75) as prepaid Base Rent to be applied against the first obligation of Tenant to pay Base Rent for the Expansion Premises. Base Rent for the Expansion Premises during the initial Term shall be as follows:

| | |
|---|---|
| (i) For the period commencing on the Expansion Premises Commencement Date (subject to Paragraph 5(d)) through the day immediately preceding the first day of the calendar month in which the first (1st) annual anniversary of the Expansion Premises Commencement Date occurs (the "I-Year Anniversary"); | $37,269.75 (per month);<br>$447,237.00 (per year); |

*[CONTINUED ON FOLLOWING PAGE]*

| | |
|---|---|
| (ii) For the period commencing on the I-Year Anniversary through the day immediately preceding the first day of the calendar month in which the second (2nd) annual anniversary of the Expansion Premises Commencement Date occurs (the "2-Year Anniversary"); | $38,015.15 (per month); $456,181.80 (per year); |
| (iii) For the period commencing on the 2-Year Anniversary through the day immediately preceding the first day of the calendar month in which the third (3rd) annual anniversary of the Expansion Premises Commencement Date occurs (the "3-Year Anniversary"); | $38,775.45 (per month); $465,305.40 (per year); |
| (iv) For the period commencing on the 3-Year Anniversary through the day immediately preceding the first day of the calendar month in which the fourth (4th) annual anniversary of the Expansion Premises Commencement Date occurs (the "4-Year Anniversary"); | $39,550.96 (per month); $474,611.52 (per year); |
| (v) For the period commencing on the 4-Year Anniversary through the last day of the Term. | $40,341.98 (per month); $484,103.76 (per year); |

6. <u>Extension Option.</u> Tenant shall have the right to extend the Term of the Lease with respect to. the Premises pursuant to the terms and conditions set forth in <u>Section 36</u> of the Existing Lease, except that the Base Rent attributable to the Expansion Premises during the Extension Term shall be equal to one hundred two percent (102%) of the Base Rent attributable to the Expansion Premises immediately preceding the Extension Term, and shall increase annually thereafter by two percent (2%).

7. <u>Janitorial.</u> Tenant shall, at Tenant's sole cost and expense, provide janitorial services to the Premises and the Building. All janitorial services shall be of a standard that is substantially equivalent to the services provided in similar industrial buildings in the City of Moorpark.

8. Brokers. Except for Cresa, Tenant warrants that no real estate brokerage firm or agent or other person can claim a right through its dealings with Tenant to a commission or finder's fee in connection with the negotiation of this First Amendment and that no real estate commissions or finder's fees are payable in connection herewith. Tenant shall indemnify, defend and hold Landlord harmless from all expenses, claims, damages (including a reasonable attorney's fee and costs) incurred by Landlord as a result of a breach of this warranty.

9. Miscellaneous.

(a) Binding Effect. The terms of this First Amendment shall apply to, bind and inure to the benefit of the heirs, successors, executors, legal and personal representatives, administrators and assigns of the parties, as the case may be.

(b) Entire Agreement. This First Amendment constitutes the entire understanding and agreement of the parties with respect to the subject matter hereof, and shall supersede and replace all prior understandings and agreements, whether oral or in writing.

(c) Attorneys' Fees. If there is any legal action or proceeding to enforce or interpret any provision of this First Amendment or to protect or establish any right or remedy of any party, the unsuccessful party to such action or proceeding shall pay to the prevailing party as finally determined, all costs and expenses, including, without limitation, reasonable attorneys' fees and costs, incurred by such prevailing party in such action or proceeding, in enforcing such judgment, and in connection with any appeal from such judgment.

(d) Ratification. Landlord and Tenant hereby ratify and confirm their respective rights and obligations under the Lease. Except as specifically herein amended, the Lease is and shall remain in full force and effect according to the terms thereof. In the event of any conflict between the terms of the Lease and the terms of this First Amendment, the terms of this First Amendment shall control.

(e) Headings. The headings to sections of this Agreement are for convenient reference only and shall not be used in interpreting this First Amendment.

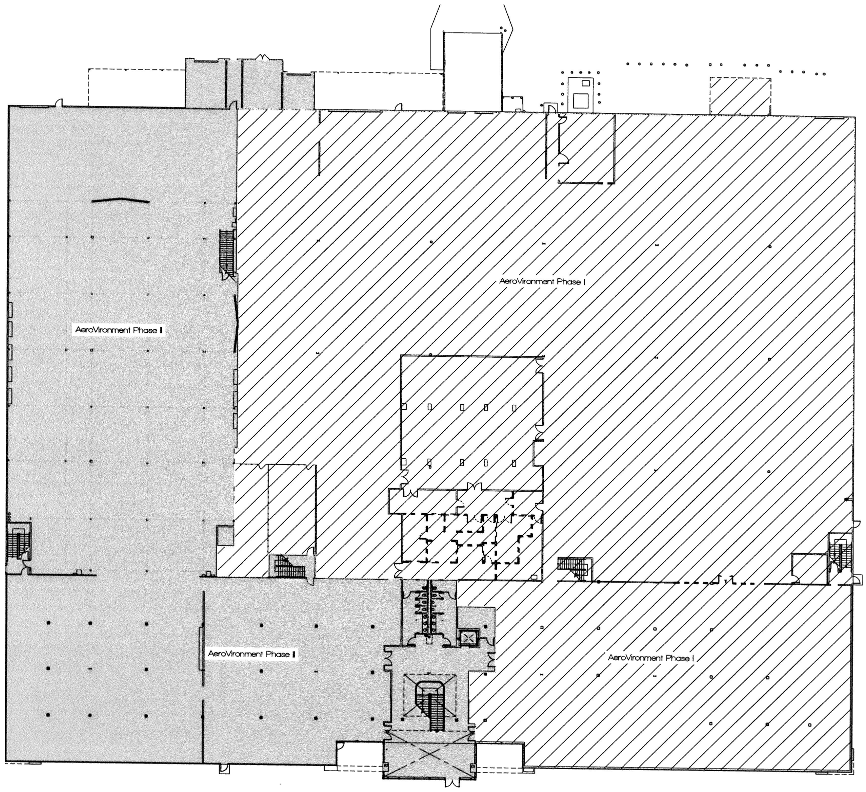
(f) Counterparts. This First Amendment may be executed in counterparts, each of which shall be deemed to be an original, but all of which together shall constitute one and the same agreement. This First Amendment may be executed by a party's signature transmitted by facsimile ("fax") or email or by a party's electronic signature, and copies of this First Amendment executed and delivered by means of faxed or emailed copies of signatures or originals of this First Amendment executed by electronic signature shall have the same force and effect as copies hereof executed and delivered with original wet signatures. The parties may rely upon faxed, emailed or electronic signatures as if such signatures were original wet signatures. Any party executing and delivering this First Amendment by fax or email shall promptly thereafter deliver a counterpart signature page of this First Amendment containing said party's original signature. The parties agree that a faxed or emailed signature page or an electronic signature may be introduced into evidence in any proceeding arising out of or related to this First Amendment as if it were an original wet signature page.

**IN WITNESS WHEREOF,** the parties have executed this First Amendment as of the date first written above.

| **TENANT:** | **LANDLORD:** |
| --- | --- |
| **AEROVIRONMENT, INC.,**<br>a Delaware corporation | **PRINCETON AVENUE HOLDINGS, LLC,**<br>a California limited liability company |
| By: /s/ Kirk J. Flittie<br>Name: Kirk J. Flittie<br>Its: VP & GM | By: Nearon Enterprises, a California corporation<br>Its: Designated |
| | By: /s/ Anthony Perino<br>Anthony Perino, President |

# EXHIBIT A

## Expansion Premises

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aerovironment - first floor plan

scale, 1/16" = 1'-0'

space study for-

Nearon Enterprises

14501 p('inceton avenue.
moorpark california

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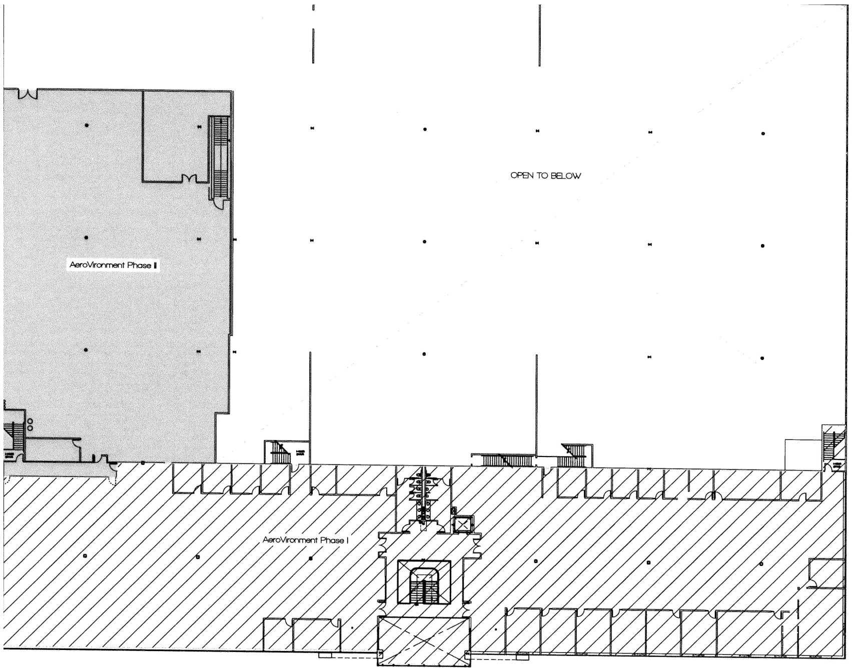



aerovironment - second floor plan

scale, 1116' = l'-0"

space stt.d for,

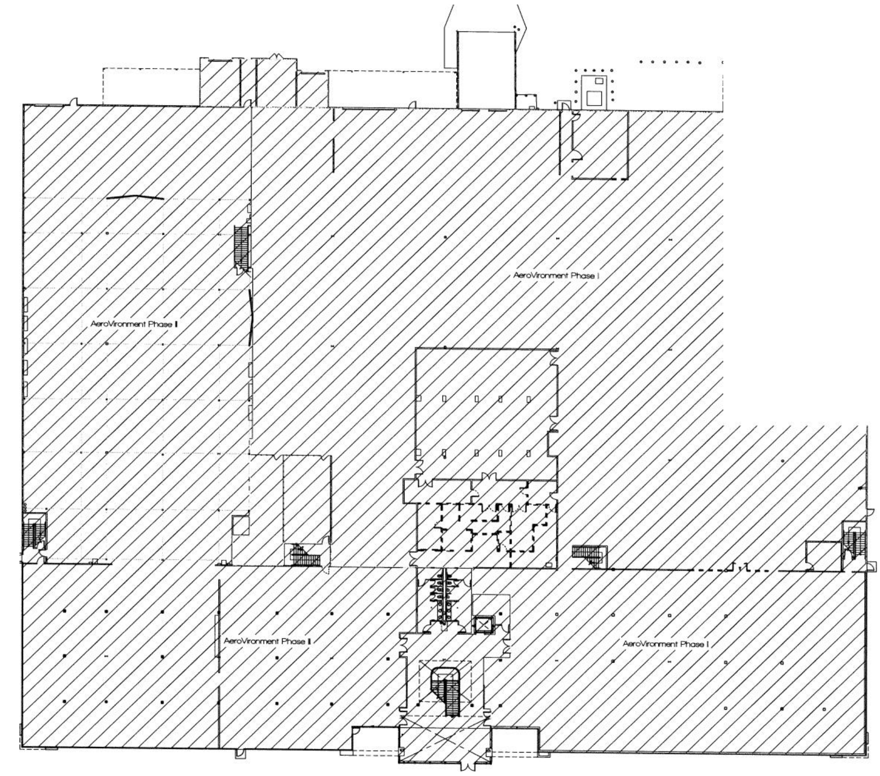
Nearon Enterprises

IY501 princeton avenue

moorpark califomia

**EXHIBIT A-1**

**Premises**
**(after inclusion of the Expansion Premises)**




**aerovironment - first floor plan**

scale, 1/16" = 1'-0"

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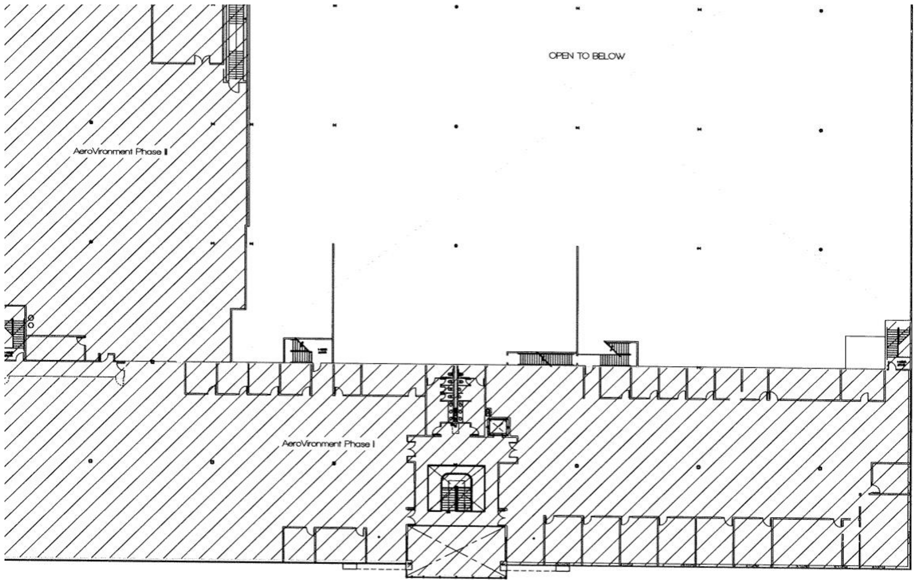
Nearon Enterpri.ses

14501 punceton avenue

moor-park california

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aerovironment - second floor plan
scale l/16" = l'-0"

space stt.dlj for,
Nearon Enterprises
IYSO1 princeton avenue
moorpark, califonl®

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**EXHIBIT B**

**Work Letter**

This Work Letter shall set forth the terms and conditions relating to the construction of the tenant improvements in the Expansion Premises (the "Expansion Premises Tenant Improvements").

SECTION 1

CONSTRUCTION DRAWINGS

1.1 Selection of Architect/Construction Drawings. Tenant shall retain a California licensed architect (the "Architect") to prepare the Construction Drawings (as defined below). Tenant shall retain a California licensed engineering company (the "Engineers") to prepare all plans and engineering working drawings relating to the structural, mechanical, electrical, plumbing, HVAC, lifesafety, and sprinkler work in the Expansion Premises. The plans and drawings to be prepared by Architect and the Engineers hereunder shall be known collectively as the "Construction Drawings." All Construction Drawings shall comply with the drawing format and specifications determined by Landlord, and shall be subject to Landlord's approval. Tenant and Architect shall verify, in the field, the dimensions and conditions as shown on the relevant portions of the base building plans, and Tenant and Architect shall be solely responsible for the same, and Landlord shall have no responsibility in connection therewith. Landlord's review of the Construction Drawings as set forth in this Section 1 shall be for its sole purpose and shall not imply Landlord's review of the same, or obligate Landlord to review the same, for quality, design, code compliance or other like matters. Accordingly, notwithstanding that any Construction Drawings are reviewed by Landlord or its space planner, architect, engineers and consultants, and notwithstanding any advice or assistance which may be rendered to Tenant by Landlord or Landlord's space planner, architect, engineers, and consultants, Landlord shall have no liability whatsoever in connection therewith and shall not be responsible for any omissions or errors contained in the Construction Drawings, and Tenant's waiver and indemnity set forth in Section 14 of the Existing Lease shall specifically apply to the Construction Drawings.

1.2 Final Space Plan. Tenant shall supply Landlord with four (4) copies signed by Tenant of its final space plan for the Expansion Premises before any architectural working drawings or engineering drawings have been commenced. The final space plan (the "Final Space Plan") shall include a layout and designation of all offices, rooms and other partitioning, their intended use, and equipment to be contained therein. Landlord may request clarification or more specific drawings for special use items not included in the Final Space Plan. Landlord shall advise Tenant within five (5) business days after Landlord's receipt of the Final Space Plan for the Expansion Premises if the same is unsatisfactory or incomplete in any respect. If Tenant is so advised, Tenant shall promptly cause the Final Space Plan to be revised to correct any deficiencies or other matters Landlord may reasonably require.

1.3 Final Working Drawings. After the Final Space Plan has been approved by Landlord, Tenant shall supply the Engineers with a complete listing of standard and non-standard equipment and specifications, including, without limitation, B.T.U. calculations, electrical requirements and special electrical receptacle requirements for the Expansion Premises, to enable the Engineers and the Architect to complete the "Final Working Drawings" (as that term is defined below) in the manner as set forth below. Upon the approval of the Final Space Plan by Landlord and Tenant, Tenant shall promptly cause the Architect and the Engineers to complete the architectural and engineering drawings for the Expansion Premises, and Architect shall compile a fully coordinated set of architectural, structural, mechanical, electrical and plumbing working drawings in a form which is complete to allow subcontractors to bid on the work and to obtain all applicable permits (collectively, the "Final Working Drawings") and shall submit the same to Landlord for Landlord's approval. Tenant shall supply Landlord with four (4) copies signed by Tenant of such Final Working Drawings. Landlord shall advise Tenant within fifteen (15) business days after Landlord's receipt of the Final Working Drawings for the Expansion Premises if the same is unsatisfactory or incomplete in any respect. If Tenant is so advised, Tenant shall immediately revise the Final Working Drawings in accordance with such review and any disapproval of Landlord in connection therewith.

1.4 Approved Working Drawings. The Final Working Drawings shall be approved by Landlord (the "Approved Working Drawings") prior to the commencement of construction of the Expansion Premises Tenant Improvements by Tenant. After approval by Landlord of the Final Working Drawings, Tenant may submit the same to the City of Moorpark for all applicable building permits. Tenant hereby agrees that neither Landlord nor Landlord's consultants shall be responsible for obtaining any building permit or certificate of occupancy for the Expansion Premises Tenant Improvements and that obtaining the same shall be Tenant's responsibility; provided, however, that Landlord shall cooperate with Tenant in executing permit applications and performing other ministerial acts reasonably necessary to enable Tenant to obtain any such permit or certificate of occupancy. No changes, modifications or alterations in the Approved Working Drawings may be made without the prior written consent of Landlord, which consent may not be unreasonably withheld.

## SECTION2

## CONSTRUCTION OF THE EXPANSION PREMISES TENANT IMPROVEMENTS

2.1 Tenant's Selection of Contractors.

2.1.1 The Contractor. A California licensed general contractor shall be retained by Tenant to construct the Expansion Premises Tenant Improvements.

2.1.2 Tenant's Agents. All subcontractors, laborers, materialmen, and suppliers used by Tenant (such subcontractors, laborers, materialmen, and suppliers, and the Contractor to be known collectively as "Tenant's Agents") shall be reasonably approved by Landlord. All of Tenant's Agents must be licensed in the State of California and capable of being bonded.

2.2 Construction of Expansion Premises Tenant Improvements by Tenant's Agents.

2.2.1 Construction Contract; Cost Budget. Prior to Tenant's execution of the construction contract and general conditions with Contractor (which shall be on an AIA Standard Form of Agreement Between Owner and Contractor where the basis for payment is either the cost of the work plus a fee or a stipulated sum) (the "Contract"), Tenant shall submit the Contract to Landlord for its approval, which approval shall not be unreasonably withheld, conditioned or delayed. Prior to the commencement of the construction of the Expansion Premises Tenant Improvements, and after Tenant has accepted all bids for the Expansion Premises Tenant Improvements, Tenant shall provide Landlord with a detailed breakdown, by trade, of the final costs to be incurred or which have been incurred in connection with the design and construction of the Expansion Premises Tenant Improvements to be performed by or at the direction of Tenant or the Contractor, which costs form a basis for the amount of the Contract (the "Final Costs").

2.2.2 Tenant's Agents.

2.2.2.1 Landlord's General Conditions for Tenant's Agents and Tenant Improvement Work. Tenant and Tenant's Agent's construction of the Expansion Premises Tenant Improvements shall comply with the following: (i) the Expansion Premises Tenant Improvements shall be constructed in strict accordance with the Approved Working Drawings;
(ii) Tenant's Agents shall submit schedules of all work relating to the Tenant's Improvements to Contractor and Contractor shall, within five (5) business days of receipt thereof, inform Tenant's Agents of any changes which are necessary thereto, and Tenant's Agents shall adhere to such corrected schedule; and (iii) Tenant shall abide by all rules made by Landlord's Building manager with respect to the use of freight, loading dock and service elevators, storage of materials, coordination of work with the contractors of other tenants, and any other matter in connection with this Tenant Work Letter, including, without limitation, the construction of the Expansion Premises Tenant Improvements.

2.2.2.2 Indemnity. Tenant's indemnity of Landlord as set forth in Section 14 of the Existing Lease shall also apply with respect to any and all costs, losses, damages, injuries and liabilities related in any way to any act or omission of Tenant or Tenant's Agents, or anyone directly or indirectly employed by any of them, or in connection with Tenant's nonpayment of any amount arising out of the Expansion Premises Tenant Improvements and/or Tenant's disapproval of all or any portion of any request for payment. Such indemnity by Tenant, as set forth in 14 of the Existing Lease, shall also apply with respect to any and all costs, losses, damages, injuries and liabilities related in any way to Landlord's performance of any ministerial acts reasonably necessary (i) to permit Tenant to complete the Expansion Premises Tenant Improvements, and (ii) to enable Tenant to obtain any building permit or certificate of occupancy for the Expansion Premises.

2.2.2.3 Requirements of Tenant's Agents. Each of Tenant's Agents shall guarantee to Tenant and for the benefit of Landlord that the portion of the Expansion Premises Tenant Improvements for which it is responsible shall be free from any defects in workmanship and materials for a period of not less than one (1) year from the date of completion thereof. Each of Tenant's Agents shall be responsible for the replacement or repair, without additional charge, of all work done or furnished in accordance with its contract that shall become defective within one (I) year after the later to occur of (i) completion of the work performed by such contractor or subcontractors and (ii) the Lease Commencement Date. The correction of such work shall include, without additional charge, all additional expenses and damages incurred in connection with such removal or replacement of all or any part of the Expansion Premises Tenant Improvements, and/or the Building and/or common areas that may be damaged or disturbed thereby. All such warranties or guarantees as to materials or workmanship of or with respect to the Expansion Premises Tenant Improvements shall be contained in the Contract or subcontract and shall be written such that such guarantees or warranties shall inure to the benefit of both Landlord and Tenant, as their respective interests may appear, and can be directly enforced by either. Tenant covenants to give to Landlord, to the extent legally possible, any assignment or other assurances which may be necessary to effect such right of direct enforcement. In addition, Landlord may, in its discretion, require that Tenant or Contractor obtain payment and performance bonds in form and amount satisfactory to Landlord, or some alternate form of security satisfactory to Landlord, to ensure the lien-free completion of the Expansion Premises Tenant Improvements and naming Landlord as a co-obligee.

2.2.2.4 Insurance Requirements.

2.2.2.4.1 General Coverages. All of Tenant's Agents shall carry worker's compensation insurance covering all of their respective employees, and shall also carry public liability insurance, including property damage, all with limits, in form and with companies as are required to be carried by Tenant as set forth in Article 14 of the Existing Lease.

2.2.2.4.2 Special Coverages. If the Expansion Premises Tenant Improvements shall include adding to or extending the footprint of the Building structure,(a) Tenant shall carry "Builder's All Risk" insurance in an amount approved by Landlord covering the construction of the Expansion Premises Tenant Improvements and (b) such other insurance as Landlord may require, it being understood and agreed that the Expansion Premises Tenant Improvements shall be insured by Tenant pursuant to Article 14 of the Existing Lease immediately upon completion thereof. Any such insurance shall be in amounts and shall include such extended coverage endorsements as may be reasonably required by Landlord. All of Tenant's Agents shall carry General Liability which shall include Products Completed Operations coverage, each in amounts not less than $1,000,000 per incident, $2,000,000 in aggregate, and in form and with companies as are required to be carried by Tenant as set forth in Article 14 of the Existing Lease.

2.2.2.4.3 General Terms. Certificates for all insurance carried pursuant to this Section 2.2.2.4 shall be delivered to Landlord before the commencement of construction of the Expansion Premises Tenant Improvements and before the Contractor's equipment is moved onto the site. All such policies of insurance must contain a provision that the company writing said policy will notify Landlord prior to any cancellation or any reduction in the amounts of such insurance, and in any event Tenant shall notify Landlord in writing at least thirty (30) days prior to any such cancellation or reduction in coverage. In the event that the Expansion Premises Tenant Improvements are damaged by any cause during the course of the construction thereof, Tenant shall immediately repair the same at Tenant's sole cost and expense. Contractors and Tenant's Agents shall maintain all of the insurance coverage required pursuant to Section 2.2.2.4 in force until the Expansion Premises Tenant Improvements are fully completed and accepted by Landlord, except for any Products and Completed Operation Coverage insurance which may be required as set forth above, which is to be maintained for five (5) years following completion of the work. All policies carried under this Section 2.2.2.4 shall insure to Landlord and Tenant, as their interests may appear, as well as Contractor and Tenant's Agents. All insurance, except Workers' Compensation, maintained by Tenant's Agents shall preclude subrogation claims by the insurer against anyone insured thereunder. Such insurance shall provide that it is primary insurance as respects the owner and that any other insurance maintained by owner is excess and noncontributing with the insurance required hereunder. The requirements for the foregoing insurance shall not derogate from the provisions for indemnification of Landlord by Tenant under Section 2.2.2.2 of this Tenant Work Letter.

2.2.3 Governmental Compliance. The Expansion Premises Tenant Improvements shall comply in all respects with the following: (i) the Code and other state, federal, city or quasi-governmental laws, codes, ordinances and regulations, as each may apply according to the rulings of the controlling public official, agent or other person; (ii) applicable standards of the American Insurance Association (formerly, the National Board of Fire Underwriters) and the National Electrical Code; and (iii) building material manufacturer's specifications.

2.2.4 Inspection by Landlord. Upon reasonable advance notice, Landlord shall have the right to inspect the Expansion Premises Tenant Improvements, provided however, that Landlord's failure to inspect the Expansion Premises Tenant Improvements shall in no event constitute a waiver of any of Landlord's rights hereunder nor shall Landlord's inspection of the Expansion Premises Tenant Improvements constitute Landlord's approval of the same. Should Landlord disapprove any portion of the Expansion Premises Tenant Improvements as a result of Landlord's reasonable determination that such Improvements materially deviate from the Approved Working Drawings or that the quality of workmanship is substandard as compared to comparable buildings in the area, Landlord shall notify Tenant in writing of such disapproval and shall specify the items disapproved and the reasons for such disapproval, and any such disapprovals by Landlord shall be rectified by Tenant at no expense to Landlord, provided however, that in the event Landlord reasonably determines that any such disapproved matter adversely affects the mechanical, electrical, plumbing, heating, ventilating and air conditioning or life-safety systems of the Building, the structure or exterior appearance of the Building (such disapproved matter, a "Significant Disapproved Matter"), Landlord shall immediately notify Tenant who shall immediately take such actions as Landlord and Tenant deem reasonably necessary, at Tenant's expense and without incurring any liability on Landlord's part), to correct any such Significant Disapproved Matter, including, without limitation, causing the cessation of performance of the construction of the Expansion Premises Tenant Improvements until such time as the Significant Disapproved Matter is corrected to Landlord's reasonable satisfaction. In the event that Tenant fails to take immediate action to correct a Significant Disapproved Matter upon receiving notice from Landlord, Landlord may, at Tenant's expense and without incurring any liability on Landlord's part, take such actions as it deems reasonably necessary to correct such Significant Disapproved Matter(s) to its reasonable satisfaction.

2.2.5 Meetings. Commencing upon the execution of this First Amendment, Tenant shall hold weekly meetings at a reasonable time, with the Architect and the Contractor regarding the progress of the preparation of Construction Drawings and the construction of the Expansion Premises Tenant Improvements, which meetings shall be held at a location mutually agreed upon by Landlord and Tenant, and Landlord and/or its agents shall receive prior notice of, and shall have the right to attend, all such meetings, and, upon Landlord's reasonable request, certain of Tenant's Agents shall attend such meetings. In addition, minutes shall be taken at all such meetings, a copy of which minutes shall be promptly delivered to Landlord. One such meeting each month shall include the review of Contractor's current request for payment.

2.3 Notice of Completion; Copy of "As Built" Plans. Within ten (10) days after completion of construction of the Expansion Premises Tenant Improvements, Tenant shall cause a Notice of Completion to be recorded in the office of the Recorder of the County of Ventura in accordance with Section 3093 of the California Civil Code or any successor statute and furnish a copy thereof to Landlord upon such recordation, and timely give all notices required pursuant to Section 3259.5 of the California Civil Code or any successor statute. If Tenant fails to do so, Landlord may execute and file such Notice of Completion and give such notices on behalf of Tenant as Tenant's agent for such purpose, at Tenant's sole cost and expense. At the conclusion of construction, (i) Tenant shall cause the Architect and Contractor (A) to update the Approved Working Drawings as necessary to reflect all changes made to the Approved Working Drawings during the course of construction, (B) to certify to the best of their knowledge that the "record set" of as-built drawings are true and correct, which certification shall survive the expiration or termination of this Lease, and (C) to deliver to Landlord two (2) sets of copies of such as-built drawings within ninety (90) days following issuance of a certificate of occupancy for the Expansion Premises, and (ii) Tenant shall deliver to Landlord a copy of all warranties, guaranties, and operating manuals and information relating to the improvements, equipment, and systems in the Expansion Premises.

## SECTION 3

## TENANT IMPROVEMENT ALLOWANCE

Provided no Event of Default has occurred, Landlord hereby agrees to reimburse Tenant an amount not to exceed One Million Four Hundred Ninety Thousand Seven Hundred Ninety and No/100 Dollars ($1,490,790.00) (the "Allowance") for the design, permitting and construction of the Expansion Premises Tenant Improvements. The Allowance must be used within twelve (12) months following the delivery of possession of the Expansion Premises or shall be deemed forfeited with no further obligation by Landlord with respect thereto. Tenant shall not be entitled to use any portion of the Allowance for anything other than the design, permitting and construction of the Expansion Premises Tenant Improvements. In no event shall Lessor be obligated to make disbursements with respect to the Expansion Premises Tenant Improvements in an amount that exceeds the Allowance, and in no event shall Tenant be entitled to any excess, credit, deduction or offset against Rent for any unused portion of the Allowance. Provided Lessee is open for business and paying rent, said reimbursement shall be made within forty-five (45) days of Lessor's receipt of written request by Tenant to Landlord and must include the following in a form satisfactory to Landlord:

(i) Tenant has completed the Expansion Premises Tenant Improvements in accordance with the Approved Working Drawings and has commenced operations in the Expansion Premises for the Permitted Use;

(ii) Tenant has not committed any material breach of the Lease which has not been cured within the time period required for cure under this Lease or which is not curable;

(iii) Tenant has recorded a notice of completion with respect to the Expansion Premises Tenant Improvements in accordance with applicable laws after the completion of all Expansion Premises Tenant Improvements, thirty (30) days have passed after the filing of the notice, and a copy of the notice has been delivered to Landlord;

(iv) All mechanic's liens which have been filed with respect to the Expansion Premises Tenant Improvements have been paid and removed from title to the Project;

(v) All appropriate government agencies have conducted final inspections of the Expansion Premises Tenant Improvements and have issued a certificate of occupancy or equivalent, and Tenant has delivered a copy of the certificate of occupancy or equivalent to Landlord;

(vi) Tenant has delivered to Landlord receipts and other reasonable proof that Tenant has incurred the costs for which Lessee is seeking reimbursement;

(vii) Tenant has delivered to Landlord copies of executed, notarized unconditional lien releases for final payment with respect to all costs for which Tenant is seeking reimbursement (provided that if Tenant is unable to obtain such lien releases from subcontractors which provided materials and services with a claimed value of less than $5,000, then Tenant may deliver in lieu thereof an affidavit of payment of payment thereof from Tenant's general contractor in form and substance acceptable to Landlord) and,

(viii) Tenant has delivered to Lessor "as built" plans of the Expansion Premises Tenant Improvements showing the locations of all improvements and modifications to the Expansion Premises made by or on behalf of Tenant.

In the event this Lease is terminated for any reason prior to the end of the initial Term, Tenant hereby agrees to pay to Landlord, in addition to all other costs incurred by such termination, the unamortized value of the Allowance provided by Landlord.

## SECTION 4

## MISCELLANEOUS

4.1 Tenant's Representative. Tenant has designated Mark Lewis as its sole representative with respect to the matters set forth in this Work Letter, who shall have full authority and responsibility to act on behalf of the Tenant as required in this Work Letter.

4.2 Landlord's Representative. Landlord has designated Anthony Perino as its sole representative with respect to the matters set forth in this Work Letter, who, until further notice to Tenant, shall have full authority and responsibility to act on behalf of the Landlord as required in this Work Letter.

4.3 Time of the Essence in This Tenant Work Letter. Unless otherwise indicated, all references herein to a "number of days" shall mean and refer to calendar days. If any item requiring approval is timely disapproved by Landlord, the procedure for preparation of the document and approval thereof shall be repeated until the document is approved by Landlord.

4.4 Tenant's Lease Default. Notwithstanding any provision to the contrary contained in this Lease, if an Event of Default as described in Section 17 of the Existing Lease or this Work Letter has occurred at any time on or before the substantial completion of the Expansion Premises, then (i) in addition to all other rights and remedies granted to Landlord pursuant to this Lease, Landlord shall have the right to withhold payment of all or any portion of the Allowance and/or Landlord may cause Contractor to cease the construction of the Expansion Premises (in which case, Tenant shall be responsible for any delay in the substantial completion of the Expansion Premises caused by such work stoppage), and (ii) all other obligations of Landlord under the terms of this Work Letter shall be forgiven until such time as such default is cured pursuant to the terms of this Lease (in which case, Tenant shall be responsible for any delay in the substantial completion of the Expansion Premises caused by such inaction by Landlord).

4.5 Early Access. Provided that Tenant, its employees, contractors and agents do not interfere with, or delay, the Landlord's construction of the Landlord's Work in the Premises or otherwise, Landlord shall allow Tenant access to the Expansion Premises commencing as of the execution and delivery of the First Amendment by both parties, and delivery of any prepaid Rent by Tenant as required under the First Amendment, for the purpose of Tenant performing any building design, permitting and preparation prior to occupancy. Prior to Tenant's entry into the Expansion Premises as permitted by the terms of this paragraph, Tenant shall submit a schedule to Landlord for its approval, which schedule shall detail the timing and purpose of Tenant's entry, and shall deliver evidence of insurance coverage as required of Tenant under the Lease. Tenant's early access onto the Expansion Premises under this Section 4.5 shall be subject to all terms and conditions of the Lease (including without limitation all insurance and indemnity obligations), except for the payment of Rent.

**Exhibit 31.1**

**Certification of Principal Executive Officer**
**Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934**

I, Wahid Nawabi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AeroVironment, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 29, 2018

/s/ Wahid Nawabi
Wahid Nawabi
President and Chief Executive Officer

**Certification of Principal Financial Officer**
**Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934**

I, Teresa P. Covington, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AeroVironment, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 29, 2018

/s/ Teresa P. Covington
Teresa P. Covington
Senior Vice President and Chief Financial Officer

**Exhibit 32**

**Certification**
**Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
**(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) (the "Act"), each of the undersigned officers of AeroVironment, Inc., a Delaware corporation (the "Company"), does hereby certify, to each such officer's knowledge, that:

The Quarterly Report on Form 10-Q for the quarter ended October 27, 2018 (the "Periodic Report") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Wahid Nawabi
Wahid Nawabi
President and Chief Executive Officer

/s/ Teresa P. Covington
Teresa P. Covington
Senior Vice President and Chief Financial Officer

Dated: November 29, 2018

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.