
**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 January 25, 2014

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
(State or other jurisdiction of incorporation or organization)

95-2705790
(I.R.S. Employer Identification No.)

181 W. Huntington Drive, Suite 202
Monrovia, California
(Address of principal executive offices)

91016
(Zip Code)

(626) 357-9983
(Registrant's telephone number, including area code)

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

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

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

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

| | |
|---|---|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input checked="" type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

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

As of February 21, 2014, the number of shares outstanding of the registrant's common stock, \$0.0001 par value, was 22,785,334.

AeroVironment, Inc.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | <u>January 25, 2014</u> | <u>April 30, 2013</u> |
|--|-----------------------------|---------------------------|
| | (Unaudited) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 92,749 | \$ 75,332 |
| Short-term investments | 74,830 | 73,241 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,108 at January 25, 2014 and \$936 at April 30, 2013 | 42,617 | 19,770 |
| Unbilled receivables and retentions | 8,636 | 11,304 |
| Inventories, net | 55,441 | 62,561 |
| Income tax receivable | 5,852 | 11,777 |
| Deferred income taxes | 5,499 | 5,166 |
| Prepaid expenses and other current assets | 3,755 | 4,303 |
| Total current assets | 289,379 | 263,454 |
| Long-term investments | 45,877 | 68,916 |
| Property and equipment, net | 24,492 | 24,429 |
| Deferred income taxes | 5,548 | 5,606 |
| Other assets | 1,585 | 1,060 |
| Total assets | <u>\$ 366,881</u> | <u>\$ 363,465</u> |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 15,135 | \$ 16,144 |
| Wages and related accruals | 10,718 | 12,116 |
| Customer advances | 3,642 | 7,519 |
| Other current liabilities | 6,486 | 6,408 |
| Total current liabilities | 35,981 | 42,187 |
| Deferred rent | 1,031 | 771 |
| Liability for uncertain tax positions | 5,211 | 5,321 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.0001 par value: | | |
| Authorized shares — 10,000,000; none issued or outstanding | — | — |
| Common stock, \$0.0001 par value: | | |
| Authorized shares — 100,000,000 | | |
| Issued and outstanding shares — 22,765,820 at January 25, 2014 and 22,614,315 at April 30, 2013 | 2 | 2 |
| Additional paid-in capital | 134,251 | 130,527 |
| Accumulated other comprehensive loss | (618) | (705) |
| Retained earnings | 191,023 | 185,362 |
| Total stockholders' equity | 324,658 | 315,186 |
| Total liabilities and stockholders' equity | <u>\$ 366,881</u> | <u>\$ 363,465</u> |

See accompanying notes to consolidated financial statements (unaudited).

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

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------|---------------------|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 | January 25, 2014 | January 26, 2013 |
| Revenue: | | | | |
| Product sales | \$ 57,041 | \$ 23,496 | \$ 135,752 | \$ 104,601 |
| Contract services | 12,180 | 23,591 | 42,453 | 81,441 |
| | <u>69,221</u> | <u>47,087</u> | <u>178,205</u> | <u>186,042</u> |
| Cost of sales: | | | | |
| Product sales | 33,193 | 14,281 | 85,891 | 63,055 |
| Contract services | 8,976 | 13,133 | 28,839 | 48,173 |
| | <u>42,169</u> | <u>27,414</u> | <u>114,730</u> | <u>111,228</u> |
| Gross margin | 27,052 | 19,673 | 63,475 | 74,814 |
| Selling, general and administrative | 13,168 | 10,433 | 38,711 | 37,230 |
| Research and development | 5,241 | 10,306 | 19,292 | 27,828 |
| Income (loss) from operations | 8,643 | (1,066) | 5,472 | 9,756 |
| Other income (expense): | | | | |
| Interest income | 197 | 164 | 597 | 498 |
| Other income (expense) | 4,675 | 49 | (1,026) | 49 |
| Income (loss) before income taxes | 13,515 | (853) | 5,043 | 10,303 |
| Provision (benefit) for income taxes | 2,299 | (4,722) | (618) | (918) |
| Net income | <u>\$ 11,216</u> | <u>\$ 3,869</u> | <u>\$ 5,661</u> | <u>\$ 11,221</u> |
| Earnings per share data: | | | | |
| Basic | \$ 0.50 | \$ 0.17 | \$ 0.25 | \$ 0.51 |
| Diluted | \$ 0.49 | \$ 0.17 | \$ 0.25 | \$ 0.50 |
| Weighted average shares outstanding: | | | | |
| Basic | 22,321,368 | 22,142,917 | 22,278,225 | 22,035,007 |
| Diluted | 22,883,583 | 22,408,377 | 22,722,795 | 22,375,126 |

See accompanying notes to consolidated financial statements (unaudited).

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

| | <u>Three Months Ended</u> | | <u>Nine Months Ended</u> | |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | <u>January 25, 2014</u> | <u>January 26, 2013</u> | <u>January 25, 2014</u> | <u>January 26, 2013</u> |
| Net income | \$ 11,216 | \$ 3,869 | \$ 5,661 | \$ 11,221 |
| Other comprehensive income: | | | | |
| Unrealized gain on investments, net of tax | 58 | 15 | 87 | 42 |
| Total comprehensive income | <u>\$ 11,274</u> | <u>\$ 3,884</u> | <u>\$ 5,748</u> | <u>\$ 11,263</u> |

See accompanying notes to consolidated financial statements (unaudited).

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

| | Nine Months Ended | |
|---|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 |
| Operating activities | | |
| Net income | \$ 5,661 | \$ 11,221 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 6,799 | 8,340 |
| Provision for doubtful accounts | 269 | 338 |
| Deferred income taxes | (333) | (407) |
| Stock-based compensation | 2,687 | 2,629 |
| Change in fair value of conversion feature of convertible bonds | 1,032 | — |
| Unrealized foreign currency gain | — | (53) |
| Tax benefit from exercise of stock options | 304 | 1,536 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (23,116) | 24,479 |
| Unbilled receivables and retentions | 2,668 | 11,625 |
| Inventories | 7,120 | (20,058) |
| Income tax receivable | 5,925 | (8,349) |
| Other assets | 662 | (282) |
| Accounts payable | (1,009) | (4,436) |
| Other liabilities | (5,197) | (21,518) |
| Net cash provided by operating activities | 3,472 | 5,065 |
| Investing activities | | |
| Acquisitions of property and equipment | (6,751) | (6,528) |
| Acquisitions of distribution and licensing rights | (750) | (850) |
| Investment in CybAero AB convertible notes | — | (3,037) |
| Net redemptions of held-to-maturity investments | 20,388 | 4,690 |
| Net sales of available-for-sale investments | 175 | 250 |
| Net cash provided by (used in) investing activities | 13,062 | (5,475) |
| Financing activities | | |
| Exercise of stock options | 883 | 165 |
| Net cash provided by financing activities | 883 | 165 |
| Net increase (decrease) in cash and cash equivalents | 17,417 | (245) |
| Cash and cash equivalents at beginning of period | 75,332 | 64,220 |
| Cash and cash equivalents at end of period | \$ 92,749 | \$ 63,975 |
| Supplemental disclosure: | | |
| Unrealized gain on long-term investments recorded in other comprehensive income, net of deferred taxes of \$57 and \$28, respectively | \$ 87 | \$ 42 |
| Reclassification from share-based liability compensation to equity | \$ — | \$ 401 |

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 and efficient energy systems for various industries and governmental agencies.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three and nine months ended January 25, 2014 are not necessarily indicative of the results for the full year ending April 30, 2014. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended April 30, 2013, included in the Company’s Annual Report on Form 10-K.

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

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

Segments

The Company’s products are sold and divided among two reportable segments to reflect the Company’s strategic goals. Operating segments are defined as components of an enterprise from which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker (“CODM”) in deciding how to allocate resources and in assessing performance. The Company’s CODM is the Chief Executive Officer, who reviews the revenue and gross margin results for each of these segments in order to make resource allocation decisions, including the focus of research and development (“R&D”) activities and performance assessment. The Company’s reportable segments are business units that offer different products and services and are managed separately.

Investments

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

Fair Values of Financial Instruments

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

Government Contracts

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

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

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

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 dilutive effect of potential common shares outstanding is included in diluted earnings per share and excludes any anti-dilutive effects of options, shares of unvested restricted stock and restricted stock units.

The reconciliation of basic to diluted shares is as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------|---------------------|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 | January 25, 2014 | January 26, 2013 |
| Denominator for basic earnings per share: | | | | |
| Weighted average common shares outstanding, excluding unvested restricted stock | 22,321,368 | 22,142,917 | 22,278,225 | 22,035,007 |
| Dilutive effect of employee stock options, unvested restricted stock and restricted stock units | 562,215 | 265,460 | 444,570 | 340,119 |
| Denominator for diluted earnings per share | <u>22,883,583</u> | <u>22,408,377</u> | <u>22,722,795</u> | <u>22,375,126</u> |

During the three and nine months ended January 25, 2014 and January 26, 2013, certain shares reserved for issuance upon exercise of stock options, shares of unvested restricted stock and restricted stock units were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive. The number of shares reserved for issuance upon exercise of stock options, shares of unvested restricted stock and restricted stock units that met this anti-dilutive criterion for the three months ended January 25, 2014 and January 26, 2013 was approximately 24,000 and 6,000, respectively. The number of shares reserved for issuance upon exercise of stock options, shares of unvested restricted stock and restricted stock units that met this anti-dilutive criterion for the nine months ended January 25, 2014 and January 26, 2013 was approximately 56,000 and 4,000, respectively.

Recently Issued Accounting Standards

On May 1, 2013, the Company adopted changes in accordance with guidance issued by the Financial Accounting Standards Board (“FASB”), which requires additional disclosures for the reclassification of significant amounts from accumulated comprehensive income to net income. This guidance requires that certain significant amounts be presented either on the face of the consolidated statements of income or in a single note. For other amounts, the Company is required to cross-reference disclosures that provide additional detail about such amounts. The adoption of these changes did not have a material impact on the Company’s consolidated financial statements.

In July 2013, the FASB issued guidance regarding the classification of an unrecognized tax benefit as a reduction of a deferred tax asset when a net operating loss carry-forward, a similar tax loss, or a tax credit carry-forward exists. This guidance became effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption and retrospective application is permitted. The adoption of this change is not expected to have a material impact on the Company’s consolidated financial statements.

2. Investments

Investments consist of the following (in thousands):

| | January 25, 2014 | April 30, 2013 |
|--------------------------------------|---------------------|-------------------|
| Short-term investments: | | |
| Held-to-maturity securities: | | |
| Municipal securities | \$ 74,830 | \$ 73,241 |
| Total short-term investments | <u>\$ 74,830</u> | <u>\$ 73,241</u> |
| Long-term investments: | | |
| Held-to-maturity securities: | | |
| Municipal securities | \$ 27,551 | \$ 54,158 |
| Certificates of deposit | 4,632 | — |
| Total held-to-maturity investments | <u>32,183</u> | <u>54,158</u> |
| Available-for-sale securities: | | |
| Auction rate securities | 5,483 | 5,687 |
| Convertible bonds | 8,211 | 9,071 |
| Total available-for-sale investments | <u>13,694</u> | <u>14,758</u> |
| Total long-term investments | <u>\$ 45,877</u> | <u>\$ 68,916</u> |

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

Held-To-Maturity Securities

At January 25, 2014 and April 30, 2013, the balance of held-to-maturity securities consisted of state and local government municipal securities 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 January 25, 2014, were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|-------------------|------------------------------|-------------------------------|-------------------|
| Municipal securities | \$ 102,381 | \$ 101 | \$ (2) | \$ 102,480 |
| Certificates of deposit | 4,632 | — | — | 4,632 |
| Total held-to-maturity investments | \$ 107,013 | \$ 101 | \$ (2) | \$ 107,112 |

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of April 30, 2013, were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|-------------------|------------------------------|-------------------------------|-------------------|
| Municipal securities | \$ 127,399 | \$ 49 | \$ (23) | \$ 127,425 |
| Total held-to-maturity investments | \$ 127,399 | \$ 49 | \$ (23) | \$ 127,425 |

The amortized cost and fair value of the held-to-maturity securities by contractual maturity at January 25, 2014, were as follows (in thousands):

| | Cost | Fair Value |
|--|-------------------|-------------------|
| Due within one year | \$ 74,830 | \$ 74,892 |
| Due after one year through three years | 32,183 | 32,220 |
| Total | \$ 107,013 | \$ 107,112 |

Available-For-Sale Securities

Auction Rate Securities

As of January 25, 2014, the entire balance of available-for-sale auction rate securities consisted of three investment grade auction rate municipal bonds with maturities ranging from 6 to 21 years. These investments have characteristics similar to short-term investments, because at pre-determined intervals, generally ranging from 30 to 35 days, there is a new auction process at which the interest rates for these securities are reset to current interest rates. At the end of such period, the Company chooses to roll-over its holdings or redeem the investments for cash. A market maker facilitates the redemption of the securities and the underlying issuers are not required to redeem the investment within 365 days. Interest earned from these investments is recorded in interest income.

During the fourth quarter of the fiscal year ended April 30, 2008, the Company began experiencing failed auctions on some of its auction rate securities. A failed auction occurs when a buyer for the securities cannot be obtained and the market maker does not buy the security for its own account. The Company continues to earn interest on the investments that failed to settle at auction, at the maximum contractual rate until the next auction occurs. In the event the Company needs to access funds invested in these auction rate securities, the Company may not be able to liquidate these securities at the fair value recorded on January 25, 2014 until a future auction of these securities is successful or a buyer is found outside of the auction process.

As a result of the failed auctions, the fair values of these securities are estimated utilizing a discounted cash flow analysis as of January 25, 2014. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the estimated date upon which the security is expected to have a successful auction.

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

Based on the Company's ability to access its cash and cash equivalents, expected operating cash flows, and other sources of cash, the Company does not anticipate the current lack of liquidity of these investments will affect its ability to operate the business in the ordinary course. The Company believes the current lack of liquidity of these investments is temporary and expects that the securities will be redeemed or refinanced at some point in the future. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible impairment if a further decline in fair value occurs. The auction rate securities have been in an unrealized loss position for more than 12 months. The Company has the ability and the intent to hold these investments until a recovery of fair value, which may be at maturity and as of January 25, 2014, the Company did not consider these investments to be other-than-temporarily impaired.

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale investments as of January 25, 2014, were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|-----------------|
| Auction rate securities | \$ 6,575 | \$ — | \$ (1,092) | \$ 5,483 |
| Total available-for-sale investments | <u>\$ 6,575</u> | <u>\$ —</u> | <u>\$ (1,092)</u> | <u>\$ 5,483</u> |

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale investments as of April 30, 2013, were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|-----------------|
| Auction rate securities | \$ 6,750 | \$ — | \$ (1,063) | \$ 5,687 |
| Total available-for-sale investments | <u>\$ 6,750</u> | <u>\$ —</u> | <u>\$ (1,063)</u> | <u>\$ 5,687</u> |

The amortized cost and fair value of the auction rate securities by contractual maturity at January 25, 2014, were as follows (in thousands):

| | Cost | Fair Value |
|---------------------------------|-----------------|-----------------|
| Due after five through 10 years | \$ 1,300 | \$ 1,207 |
| Due after 10 years | 5,275 | 4,276 |
| Total | <u>\$ 6,575</u> | <u>\$ 5,483</u> |

Convertible Bonds

As of January 25, 2014, the entire balance of available-for-sale convertible bonds consisted of two convertible bonds. The two convertible bonds were issued by CybAero AB ("CybAero"), a publicly traded company in Sweden that develops and manufactures unmanned aerial vehicles. Each bond is in the amount of 10 million Swedish Kronor ("SEK") and is convertible into 1 million CybAero shares at the conversion price of 10 SEK per share. The maturity date of each of the bonds is November 30, 2017 and each bond bears an annual interest rate of 5%.

The Company can exercise its conversion right at any time through October 31, 2017. CybAero can prepay the bonds with three months notice to the Company and the Company may exercise its conversion rights during such three-month period. If certain conditions are satisfied after November 30, 2015, CybAero can require the Company to convert the two bonds in their entirety into CybAero shares.

The convertible bonds each contain an embedded conversion feature which is bifurcated from the bond. The changes in the fair value of the embedded conversion feature are recorded in other income (expense) in the statement of income. Unrealized gains and losses associated with the bonds are excluded from earnings and reported as a separate component of stockholders' equity, net of deferred income taxes.

On May 14, 2013, CybAero effected a reverse stock split whereby every ten shares of CybAero were converted into one share. All amounts discussed as of January 25, 2014 reflect this reverse stock split.

On February 12, 2014, CybAero adjusted the conversion price of each convertible bond, pursuant to anti-dilution provisions in the convertible bonds agreement, from 10 SEK to 9.41 SEK and increased the number of shares per bond from 1,000,000 to 1,062,699. The adjusted conversion price and increased share count was effective February 12, 2014 and the impact of the change on fair value of the convertible bonds will be reflected in the fourth quarter and year ending April 30, 2014.

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

On February 28, 2014, the Company exercised its conversion right and notified CybAero that it will convert one convertible bond into CybAero common shares. The convertible bond is in the amount of 10 million SEK and is being converted into 1,062,699 common shares of CybAero at the conversion price of 9.41 SEK. CybAero has 30 days to register and deliver the common shares to the Company. The conversion will be reflected in the fourth quarter and year ending April 30, 2014.

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale convertible bonds as of January 25, 2014, were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|-----------------|
| Convertible bonds | \$ 3,037 | \$ 5,174 | \$ — | \$ 8,211 |
| Total available-for-sale investments | <u>\$ 3,037</u> | <u>\$ 5,174</u> | <u>\$ —</u> | <u>\$ 8,211</u> |

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale convertible bonds as of April 30, 2013, were as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|-----------------|
| Convertible bonds | \$ 3,037 | \$ 6,173 | \$ (139) | \$ 9,071 |
| Total available-for-sale investments | <u>\$ 3,037</u> | <u>\$ 6,173</u> | <u>\$ (139)</u> | <u>\$ 9,071</u> |

The amortized cost and fair value of the convertible bonds by contractual maturity at January 25, 2014, were as follows (in thousands):

| | Cost | Fair Value |
|-----------------------|-----------------|-----------------|
| Due within five years | \$ 3,037 | \$ 8,211 |
| Total | <u>\$ 3,037</u> | <u>\$ 8,211</u> |

3. Fair Value Measurements

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

- Level 1 — Inputs to the valuation based upon quoted prices (unadjusted) for identical assets or liabilities in active markets that are accessible as of the measurement date.
- Level 2 — Inputs to the valuation include quoted prices in either markets that are not active, or in active markets for similar assets or liabilities, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data.
- Level 3 — Inputs to the valuation that are unobservable inputs for the asset or liability.

The Company's financial assets measured at fair value on a recurring basis at January 25, 2014, were as follows (in thousands):

| Description | Fair Value Measurement Using | | | Total |
|-------------------------|---|---|--|------------------|
| | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) | |
| Auction rate securities | \$ — | \$ — | \$ 5,483 | \$ 5,483 |
| Convertible bonds | — | 5,140 | 3,071 | 8,211 |
| Total | <u>\$ —</u> | <u>\$ 5,140</u> | <u>\$ 8,554</u> | <u>\$ 13,694</u> |

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

Due to the auction failures of the Company's auction rate securities that began in the fourth quarter of fiscal 2008, there are still no quoted prices in active markets for identical assets as of January 25, 2014. Therefore, the Company has classified its auction rate securities as Level 3 financial assets. The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis in the table above that used significant unobservable inputs (Level 3) (in thousands):

| Description | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | |
|--|---|--------------|
| Balance at April 30, 2013 | \$ | 8,585 |
| Transfers to Level 3 | | — |
| Total gains (realized or unrealized) | | — |
| Included in earnings | | — |
| Included in other comprehensive income | | 144 |
| Purchases, issuances and settlements, net | | (175) |
| Balance at January 25, 2014 | \$ | <u>8,554</u> |
| The amount of total gains or (losses) for the period included in earnings (or change in net assets) attributable to the change in unrealized gains or losses relating to assets still held at January 25, 2014 | \$ | — |

The auction rate securities are valued using a discounted cash flow model. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the estimated date upon which the security is expected to have a successful auction. As of January 25, 2014, the inputs used in the Company's discounted cash flow analysis included current coupon rates ranging from 0.1% to 0.3%, estimated redemption periods of 6 to 21 years and discount rates of 7.4% to 19.6%. The discount rates were based on market rates for municipal bond securities, as adjusted for a risk premium to reflect the lack of liquidity of these investments.

The bond components of the convertible bonds are considered level 3 assets and are valued using a discounted cash flow model. The analysis considers, among other items, the creditworthiness of the counterparty, the timing of expected future cash flows, and the maturity of the bonds. As of January 25, 2014, the inputs used in the Company's discounted cash flow analysis included a coupon rate of 5.0%, estimated redemption period of approximately four years and a discount rate of 5.4%.

The embedded conversion features of the convertible bonds are considered level 2 assets and are valued using a binomial option pricing model, which uses inputs such as CybAero's stock price, conversion price, volatility and risk-free interest rate.

4. Inventories, net

Inventories consist of the following (in thousands):

| | January 25, 2014 | April 30, 2013 |
|------------------------------------|---------------------|-------------------|
| Raw materials | \$ 15,023 | \$ 12,845 |
| Work in process | 7,961 | 16,745 |
| Finished goods | 37,292 | 36,842 |
| Inventories, gross | 60,276 | 66,432 |
| Reserve for inventory obsolescence | (4,835) | (3,871) |
| Inventories, net | <u>\$ 55,441</u> | <u>\$ 62,561</u> |

5. 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 nine months ended January 25, 2014 and January 26, 2013 (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|-------------------------|---------------------|---------------------|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 | January 25, 2014 | January 26, 2013 |
| Beginning balance | \$ 1,640 | \$ 1,259 | \$ 1,514 | \$ 2,872 |
| Warranty expense | 534 | 500 | 1,352 | 1,708 |
| Warranty claims settled | (317) | (390) | (1,009) | (3,211) |
| Ending balance | <u>\$ 1,857</u> | <u>\$ 1,369</u> | <u>\$ 1,857</u> | <u>\$ 1,369</u> |

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

6. Accumulated Other Comprehensive Loss

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

| | Available-for-sale securities | Accumulated Other Comprehensive Loss |
|--------------------------------|----------------------------------|---|
| Balance as of April 30, 2013 | \$ (705) | \$ (705) |
| Unrealized income | 144 | 144 |
| Income taxes | (57) | (57) |
| Balance as of January 25, 2014 | <u>\$ (618)</u> | <u>\$ (618)</u> |

7. Customer-Funded Research & Development

Customer-funded R&D costs are incurred pursuant to contracts (revenue arrangements) to perform R&D activities according to customer specifications. These costs are direct contract costs and are expensed to cost of sales when the corresponding revenue is recognized, which is generally as the R&D services are performed. Revenue from customer-funded R&D was approximately \$5.0 million and \$21.9 million for the three and nine months ended January 25, 2014, respectively. Revenue from customer-funded R&D was approximately \$11.1 million and \$28.1 million for the three and nine months ended January 26, 2013, respectively.

8. Income Taxes

For the three and nine months ended January 25, 2014, the Company recorded a provision (benefit) for income taxes of \$2.3 million and \$(0.6) million, respectively, yielding an effective tax rate of 17.0% and (12.3)%, respectively. For the three and nine months ended January 26, 2013, the Company recorded a benefit for income taxes of \$4.7 million and \$0.9 million, respectively, yielding an effective tax rate of 553.6% and (8.9)%, respectively. The variance from statutory tax rates for the three and nine months ended January 25, 2014 and January 26, 2013 was primarily due to federal research and development tax credits.

9. Segment Data

The Company's product segments are as follows:

- Unmanned Aircraft Systems ("UAS") — The UAS segment focuses primarily on the design, development, production, support and operation of innovative UAS and tactical missile systems that provide situational awareness, multi-band communications, force protection and other mission effects to increase the security and effectiveness of the operations of the Company's customers.
- Efficient Energy Systems ("EES") — The EES segment focuses primarily on the design, development, production, marketing, support and operation of innovative efficient electric energy systems that address the growing demand for electric transportation solutions.

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

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

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 | January 25, 2014 | January 26, 2013 |
| Revenue: | | | | |
| UAS | \$ 57,491 | \$ 37,665 | \$ 148,781 | \$ 151,904 |
| EES | 11,730 | 9,422 | 29,424 | 34,138 |
| Total | 69,221 | 47,087 | 178,205 | 186,042 |
| Cost of sales: | | | | |
| UAS | 33,565 | 20,585 | 93,444 | 88,620 |
| EES | 8,604 | 6,829 | 21,286 | 22,608 |
| Total | 42,169 | 27,414 | 114,730 | 111,228 |
| Gross margin: | | | | |
| UAS | 23,926 | 17,080 | 55,337 | 63,284 |
| EES | 3,126 | 2,593 | 8,138 | 11,530 |
| Total | 27,052 | 19,673 | 63,475 | 74,814 |
| Selling, general and administrative | 13,168 | 10,433 | 38,711 | 37,230 |
| Research and development | 5,241 | 10,306 | 19,292 | 27,828 |
| Income (loss) from operations | 8,643 | (1,066) | 5,472 | 9,756 |
| Other income (expense): | | | | |
| Interest income | 197 | 164 | 597 | 498 |
| Other income (expense) | 4,675 | 49 | (1,026) | 49 |
| Income (loss) before income taxes | \$ 13,515 | \$ (853) | \$ 5,043 | \$ 10,303 |

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

This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "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 II, Item 1A, "Risk Factors."

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

Critical Accounting Policies and Estimates

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

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There have been no material changes made to the critical accounting estimates during the periods presented in the consolidated financial statements from those disclosed in the Form 10-K for the fiscal year ended April 30, 2013.

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 2014 fiscal year ends on April 30, 2014 and our fiscal quarters end on July 27, 2013, October 26, 2013 and January 25, 2014.

Results of Operations

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

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

Three Months Ended January 25, 2014 Compared to Three Months Ended January 26, 2013

| | Three Months Ended | |
|-------------------------------------|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 |
| Revenue: | | |
| UAS | \$ 57,491 | \$ 37,665 |
| EES | 11,730 | 9,422 |
| Total | 69,221 | 47,087 |
| Cost of sales: | | |
| UAS | 33,565 | 20,585 |
| EES | 8,604 | 6,829 |
| Total | 42,169 | 27,414 |
| Gross margin: | | |
| UAS | 23,926 | 17,080 |
| EES | 3,126 | 2,593 |
| Total | 27,052 | 19,673 |
| Selling, general and administrative | 13,168 | 10,433 |
| Research and development | 5,241 | 10,306 |
| Income (loss) from operations | 8,643 | (1,066) |
| Other income: | | |
| Interest income | 197 | 164 |
| Other income | 4,675 | 49 |
| Income (loss) before income taxes | \$ 13,515 | \$ (853) |

Revenue. Revenue for the three months ended January 25, 2014 was \$69.2 million, compared to \$47.1 million for the three months ended January 26, 2013, representing an increase of \$22.1 million, or 47%. UAS revenue increased by \$19.8 million, or 53%, to \$57.5 million for the three months ended January 25, 2014, primarily due to higher product deliveries of \$31.0 million, offset by lower customer-funded R&D revenue of \$5.9 million and lower service revenue of \$5.2 million. The increase in product deliveries was primarily due to higher deliveries of Raven and Puma systems and spares. The decrease in customer-funded R&D revenue was primarily due to the transition of Switchblade from a developmental program into low-rate production and no revenue associated with the Global Observer cost reimbursements. The decrease in service revenue was primarily due to reduced logistic services for small UAS. EES revenue increased by \$2.3 million, or 24%, to \$11.7 million for the three months ended January 25, 2014. The increase in EES revenue was primarily due to higher deliveries of passenger electric vehicle charging systems and industrial fast charge systems, offset by lower deliveries of electric vehicle test systems.

Cost of Sales. Cost of sales for the three months ended January 25, 2014 was \$42.2 million, compared to \$27.4 million for the three months ended January 26, 2013, representing an increase of \$14.8 million, or 54%. As a percentage of revenue, cost of sales increased from 58% to 61%. UAS cost of sales increased \$13.0 million for the three months ended January 25, 2014 due to higher sales volume.

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As a percentage of revenue, cost of sales for UAS increased from 55% to 58% due to lower absorption of manufacturing and engineering overhead support costs. EES cost of sales increased \$1.8 million, or 26%, to \$8.6 million for the three months ended January 25, 2014 due to higher sales volume. As a percentage of revenue, cost of sales for EES increased from 72% to 73%.

Gross Margin. Gross margin for the three months ended January 25, 2014 was \$27.1 million, compared to \$19.7 million for the three months ended January 26, 2013, representing an increase of \$7.4 million, or 38%. UAS gross margin increased \$6.8 million, or 40%, to \$23.9 million for the three months ended January 25, 2014, primarily due to higher sales volume. As a percentage of revenue, gross margin for UAS decreased from 45% to 42%, due to lower absorption of manufacturing and engineering overhead support costs. In addition, the three months ended January 26, 2013 included reimbursement costs for the Global Observer Joint Capability Technology Demonstration contract. EES gross margin increased \$0.5 million, or 21%, to \$3.1 million for the three months ended January 25, 2014, primarily due to higher sales volume. As a percentage of revenue, EES gross margin decreased from 28% to 27%.

Selling, General and Administrative. SG&A expense for the three months ended January 25, 2014 was \$13.2 million, or 19% of revenue, compared to SG&A expense of \$10.4 million, or 22% of revenue, for the three months ended January 26, 2013. SG&A expense for the three months ended January 26, 2013 included a reduction of accrued incentive compensation as a result of not achieving anticipated financial performance.

Research and Development. R&D expense for the three months ended January 25, 2014 was \$5.2 million, or 8% of revenue, compared to R&D expense of \$10.3 million, or 22% of revenue, for the three months ended January 26, 2013. The decrease was primarily due to lower spending on R&D initiatives.

Interest Income. Interest income was \$0.2 million for both the three months ended January 25, 2014 and January 26, 2013.

Other Income. Other income for the three months ended January 25, 2014 was \$4.7 million, compared to \$0 for the three months ended January 26, 2013. The increase was primarily due to a \$4.7 million increase in fair value of the embedded conversion feature of our convertible bonds investment.

Income Tax Expense. Our effective tax rate was 17.0% for the three months ended January 25, 2014, compared to a tax benefit rate of 553.6% for the three months ended January 26, 2013. The increase in tax expense was primarily due to higher income before income taxes for the three months ended January 25, 2014 compared to a loss before income taxes for the three months ended January 26, 2013.

Nine Months Ended January 25, 2014 Compared to Nine Months Ended January 26, 2013

| | Nine Months Ended | |
|-------------------------------------|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 |
| Revenue: | | |
| UAS | \$ 148,781 | \$ 151,904 |
| EES | 29,424 | 34,138 |
| Total | 178,205 | 186,042 |
| Cost of sales: | | |
| UAS | 93,444 | 88,620 |
| EES | 21,286 | 22,608 |
| Total | 114,730 | 111,228 |
| Gross margin: | | |
| UAS | 55,337 | 63,284 |
| EES | 8,138 | 11,530 |
| Total | 63,475 | 74,814 |
| Selling, general and administrative | 38,711 | 37,230 |
| Research and development | 19,292 | 27,828 |
| Income from operations | 5,472 | 9,756 |
| Other income (expense): | | |
| Interest income | 597 | 498 |
| Other (expense) income | (1,026) | 49 |
| Income before income taxes | \$ 5,043 | \$ 10,303 |

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Revenue. Revenue for the nine months ended January 25, 2014 was \$178.2 million, compared to \$186.0 million for the nine months ended January 26, 2013, representing a decrease of \$7.8 million, or 4%. UAS revenue decreased by \$3.1 million, or 2%, to \$148.8 million for the nine months ended January 25, 2014, primarily due to lower service revenue of \$31.2 million and lower customer-funded R&D revenue of \$6.5 million, offset by higher product deliveries of \$34.6 million. The decrease in service revenue was primarily due to reduced logistic services for our small UAS systems. The decrease in customer-funded R&D revenue was primarily due to the transition of Switchblade from a developmental program into low-rate production. The increase in product deliveries was primarily due to higher deliveries of our Puma AE spares. EES revenue decreased by \$4.7 million, or 14%, to \$29.4 million for the nine months ended January 25, 2014. The decrease in EES revenue was primarily due to lower deliveries of electric vehicle test systems and industrial fast charge systems, offset by higher deliveries of passenger electric vehicle charging systems.

Cost of Sales. Cost of sales for the nine months ended January 25, 2014 was \$114.7 million, compared to \$111.2 million for the nine months ended January 26, 2013, representing an increase of \$3.5 million, or 3%. As a percentage of revenue, cost of sales increased from 60% to 64%. UAS cost of sales increased \$4.8 million, or 5%, to \$93.4 million for the nine months ended January 25, 2014. As a percentage of revenue, cost of sales for UAS increased from 58% to 63% due to lower absorption of manufacturing and engineering overhead support costs, which included severance costs associated with our organizational realignment. EES cost of sales decreased \$1.3 million, or 6%, to \$21.3 million for the nine months ended January 25, 2014, primarily due to lower sales volume. As a percentage of revenue, cost of sales for EES increased from 66% to 72%, primarily due to lower absorption of manufacturing and engineering overhead support costs, which included severance costs associated with our organizational realignment.

Gross Margin. Gross margin for the nine months ended January 25, 2014 was \$63.5 million, compared to \$74.8 million for the nine months ended January 26, 2013, representing a decrease of \$11.3 million, or 15%. UAS gross margin decreased \$7.9 million, or 13%, to \$55.3 million for the nine months ended January 25, 2014, primarily due to lower absorption of manufacturing and engineering overhead support costs, which included severance costs associated with our organizational realignment. As a percentage of revenue, gross margin for UAS decreased from 42% to 37%, primarily due to lower absorption of manufacturing and engineering overhead support costs, which included severance costs associated with our organizational realignment. EES gross margin decreased \$3.4 million, or 29%, to \$8.1 million for the nine months ended January 25, 2014, primarily due to lower sales volume. As a percentage of revenue, EES gross margin decreased from 34% to 28%, primarily due to lower absorption of manufacturing and engineering overhead support costs, which included severance costs associated with our organizational realignment.

Selling, General and Administrative. SG&A expense for the nine months ended January 25, 2014 was \$38.7 million, or 22% of revenue, compared to SG&A expense of \$37.2 million, or 20% of revenue, for the nine months ended January 26, 2013.

Research and Development. R&D expense for the nine months ended January 25, 2014 was \$19.3 million, or 11% of revenue, compared to R&D expense of \$27.8 million, or 15% of revenue, for the nine months ended January 26, 2013. The decrease was primarily due to lower spending on R&D initiatives.

Interest Income. Interest income was \$0.6 million for the nine months ended January 25, 2014, compared to interest income of \$0.5 million for the nine months ended January 26, 2013.

Other Expense. Other expense for the nine months ended January 25, 2014 was \$1.0 million, compared to \$0 for the nine months ended January 26, 2013. The increase was primarily due to a \$1.0 million reduction in fair value of the embedded conversion feature of the convertible bonds investment.

Income Tax Benefit. Our tax benefit rate was 12.3% for the nine months ended January 25, 2014, compared to our tax benefit rate of 8.9% for the nine months ended January 26, 2013.

Backlog. We define funded backlog as unfilled firm orders for products and services for which funding currently is appropriated to us under the contract by the customer. As of January 25, 2014 and April 30, 2013, our funded backlog was approximately \$95.5 million and \$59.4 million, respectively.

In addition to our funded backlog, we also had unfunded backlog of \$23.6 million and \$76.6 million as of January 25, 2014 and April 30, 2013, respectively. We define unfunded backlog as the total remaining potential order amounts under sole-source 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.

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Because of possible future changes in delivery schedules and/or cancellations of orders, backlog at any particular date is not necessarily representative of actual sales to be expected for any succeeding period, and actual sales for the year may not meet or exceed the backlog represented. Our backlog is typically subject to large variations from quarter to quarter as existing contracts expire or are renewed, or new contracts are awarded. A majority of our contracts, specifically our IDIQ contracts, do not currently obligate the U.S. government to purchase any goods or services. Additionally, all U.S. government contracts included in backlog, whether or not funded, may be terminated at the convenience of the U.S. government.

Liquidity and Capital Resources

We currently have no material cash commitments, except for normal recurring trade payables, accrued expenses and ongoing research and development costs, all of which we anticipate funding through our existing working capital and funds provided by operating activities. The majority of our purchase obligations are pursuant to funded contractual arrangements with our customers. In addition, we do not currently anticipate significant investment in property, plant and equipment, and we believe that our existing cash, cash equivalents, cash provided by operating activities and other financing sources will be sufficient to meet our anticipated working capital, capital expenditure and debt service requirements, if any, during the next twelve months. There can be no assurance, however, that our business will continue to generate cash flow at current levels. Nevertheless, we anticipate that existing sources of liquidity and cash flows from operations will be sufficient to satisfy our cash needs for the foreseeable future.

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

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

Cash Flows

The following table provides our cash flow data for the nine months ended January 25, 2014 and January 26, 2013 (in thousands):

| | Nine Months Ended | |
|---|---------------------|---------------------|
| | January 25, 2014 | January 26, 2013 |
| | (Unaudited) | |
| Net cash provided by operating activities | \$ 3,472 | \$ 5,065 |
| Net cash provided by (used in) investing activities | \$ 13,062 | \$ (5,475) |
| Net cash provided by financing activities | \$ 883 | \$ 165 |

Cash Provided by Operating Activities. Net cash provided by operating activities for the nine months ended January 25, 2014 decreased by \$1.6 million to \$3.5 million, compared to net cash provided by operating activities of \$5.1 million for the nine months ended January 26, 2013. This decrease in net cash provided by operating activities was primarily due to lower net income of \$5.6 million, lower depreciation and amortization of \$1.5 million, and lower tax benefits from stock option exercises of \$1.2 million, partially offset by lower working capital needs of \$5.6 million and a \$1.0 million reduction in fair value of the embedded conversion feature of our convertible bonds investment.

Cash Provided by (Used in) Investing Activities. Net cash provided by investing activities increased by \$18.5 million to \$13.1 million for the nine months ended January 25, 2014, compared to net cash used in investing activities of \$5.5 million for the nine months ended January 26, 2013. The increase in net cash provided by investing activities was primarily due to higher net redemptions of investments of \$15.6 million.

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Cash Provided by Financing Activities. Net cash provided by financing activities was \$0.9 million for the nine months ended January 25, 2014, compared to net cash provided by financing activities of \$0.2 million for the nine months ended January 26, 2013.

Off-Balance Sheet Arrangements

During the third quarter, there were no material changes in our off-balance sheet arrangements or contractual obligations and commercial commitments from those disclosed in the Form 10-K for the fiscal year ended April 30, 2013.

Inflation

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

New Accounting Standards

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

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

Foreign Currency Exchange Rate Risk

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

ITEM 4. CONTROLS AND PROCEDURES

Controls and Procedures

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

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

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

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

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Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting or in other factors identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the quarter ended January 25, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed under Part I, Item 1A, "Risk Factors," in our Annual Report on Form 10-K for the fiscal year ended April 30, 2013. Please refer to that section for disclosures regarding the risks and uncertainties related to our business.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

| Exhibit Number | Description |
|-----------------------|---|
| 10.1 | First Amendment to Lease Agreement (900 Enchanted Way, Simi Valley, CA 93065) dated as of December 1, 2013, by and between the Company and Hillside III LLC, and related agreements |
| 10.2 | First Amendment to Lease Agreement (994 Flower Glen Street, Simi Valley, CA 93065) dated as of December 1, 2013, by and between the Company and Hillside II LLC, and related agreements |
| 10.3 | Lease Agreement (996 Flower Glen Street, Simi Valley, CA 93065) dated as of December 1, 2013, by and between the Company and Hillside II LLC, and related agreements |
| 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 Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Presentation Linkbase Document. |

SIGNATURES

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

Date: March 4, 2014

AEROVIRONMENT, INC.

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

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

FIRST AMENDMENT TO LEASE AGREEMENT
(900 Enchanted Way, Simi Valley, CA 93065)

THIS FIRST AMENDMENT TO LEASE AGREEMENT (this "Amendment"), dated for reference purposes as of December 1, 2013, is entered into by and between **HILLSIDE III LLC, a California Limited Liability Company** as Lessor, and **AEROVIRONMENT, INC, a Delaware Corporation**, as Lessee with reference to the following:

Recitals

A. Lessor and Lessee have entered into that certain AIR Commercial Real Estate Association Standard Industrial/Commercial Single Tenant Lease — Net, dated March 1, 2008, as addended (the "Lease") for that certain real property commonly known as 900 Enchanted Way, Simi Valley, CA 93065, more particularly described therein. Each initially capitalized term not defined in this Amendment shall have the meaning ascribed to such term in the Lease. Each sectional reference below shall mean and refer to the applicable paragraph of the Lease.

B. Lessor and Lessee desire and intend to amend the Lease on the terms and conditions set forth hereinbelow.

NOW, THEREFORE, in consideration of the terms and provisions contained herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Lessor and Lessee hereby amend the Lease as follows:

1. Term. Paragraph 1.3 is hereby amended to provide that the Term of the Lease is extended for six and one-half (6.5) years, commencing on December 1, 2013 and expiring on May 31, 2020 (the "Expiration Date").

2. Base Rent. Lessee agrees to pay Base Rent for the Premises during the extended term of the Lease, in advance, at such places as may be designated from time-to-time by Lessor, without deduction or offset, in the following amounts:

(i) From **DECEMBER 1, 2013 through NOVEMBER 30, 2015**: monthly installments of **\$56,321.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease;

(ii) From **DECEMBER 1, 2015 through NOVEMBER 30, 2017**: monthly installments of **\$58,856.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease;

(iii) From **DECEMBER 1, 2017 through NOVEMBER 30, 2019**: monthly installments of **\$61,505.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease; and

(iv) From **DECEMBER 1, 2019 THROUGH MAY 31, 2020**: monthly installments of **\$64,272.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease.

3. Base Rent Partial Abatement. Provided Lessee shall not be in material default of the Lease, after any applicable notice and cure periods, immediately prior to or during any Base Rent partial abatement period, as provided below, the Base Rent payable by Lessee to Lessor for the Premises, as provided in Paragraph 2 of this Amendment above, shall be partially abated to the extent provided and during the periods provided in that certain Rental Concession Agreement attached hereto.

4. Security Deposit. Lessor and Lessee acknowledge and agree that Lessor holds the sum of **ZERO** and no/100 (**\$0.00**) Dollars as Security Deposit previously received pursuant to Paragraph 5 of the Lease and Lessor shall have no liability to Lessee for the return of any Security Deposit to Lessee upon the expiration or termination of the Lease.

5. Maintenance and Repairs. Paragraph 7 is hereby amended to provide that Lessee shall be obligated to manage and contract directly for services related to Lessee's obligations to maintain the Premises, including, but not limited to, all utilities and janitorial service. Lessor shall be responsible, at Lessor's sole cost and expense, for that portion of roof replacement and future roof repair cost which exceeds \$1,000 per occurrence, per building. Lessee shall be responsible, at Lessee's sole cost and expense, for the first \$1,000 of roof replacement and future roof repair cost not payable by Lessor above. A roof assessment of the Premises shall be performed by a licensed roofing contractor. All roofing replacement and/or repair work shall be performed to applicable governmental code requirements, within one hundred and twenty (120) days of lease execution weather permitting.

6. Tax Protest. During the lease term, Lessee shall be entitled, at its election, to file a protest with the Ventura County Tax Assessor's Office to reduce the real property taxes to reflect the current valuation of the Property.

7. Exterior Windows and Doors. Prior to January 31st, 2014, subject to such extension of additional time as may be required due to weather, Lessor, at Lessor's sole cost and expense, shall repair and re-seal all exterior windows and doors of the Premises in a workman-like and professional manner, as may be required. Lessee shall maintain all exterior windows and doors of the Premises throughout Term of the Lease.

8. HVAC. Lessor and Lessee agree that, within a commercially reasonable time, upon mutual agreement of Lessor and Lessee, the HVAC units of the Premises that have exceeded their useful life and any other HVAC major components (such as compressors, fans, etc.) that fail, for reasons other than failure of Lessee to maintain such HVAC major components, during the extended Term of the Lease (collectively, the "HVAC Work") shall be repaired or replaced, as may be required, subject to the cost allocation provided below. Lessee shall not perform any of the HVAC Work without Lessor's prior approval of the work to be done and the estimated cost of such work. The cost of such HVAC Work shall be borne 50% by Lessor and 50% by Lessee and Lessee's share of such cost shall be payable by Lessee upon demand by Lessor. In lieu of paying to Lessor its 50% share of the cost of the HVAC work, Lessee shall be entitled to apply its Base Rent partial abatement or any portion thereof during the twelfth (12th) through the sixteenth (16th) months of the Term of this Lease, as provided in Paragraph 3 of this Amendment above and the attached Rental Concession Agreement, to satisfy its obligation for its share of such HVAC Work and, in the event of such election by Lessee, the amount of such Base Rent partial abatement shall be reduced by the amount of Lessee's share of the HVAC Work so applied (Base rent is not increased and remains the same. Lessee is just not entitled to offset cost of HVAC work as rent concession since Lessee did not pay). Notwithstanding the foregoing, Lessee shall maintain all HVAC units and HVAC major components during the Term through a service contract with Lessor's approved HVAC vendor.

9. Parking Area. Lessor shall, within twelve months of lease execution weather permitting (such work to be done during daylight savings time) slurry coat and restripe the parking areas of the Property, at Lessor's sole cost and expense, on non-work days (Saturdays and Sundays).

10. Rental Refund Payment. Promptly after mutual execution of this Amendment, Lessor agrees to refund to Lessee Base Rent paid by Lessee for the Premises during 2013 in the amount of \$106,670.00.

11. Option to Extend Term. Lessee shall have one (1) option to extend the Term for sixty (60) months on the terms and subject to the conditions provided in the attached Option to Renew.

12. Street Privatization. Lessor agrees to cooperate with the City of Simi Valley with respect to the privatization of Enchanted Way/Flower Glen Street. Lessee shall be responsible for obtaining all approvals and permits necessary for such privatization, at Lessee's sole cost and expense. If Enchanted Way/Flower Glen Street are successfully privatized, Lessee shall be responsible for all maintenance of such privatized street(s), at Lessee's sole cost and expense during the lease term.

13. Non-Disturbance Agreement. Lessor and Lessee acknowledge their respective rights and obligations under Paragraph 30.3 regarding Non-Disturbance Agreements

14. Warranty. Lessor and Lessee each warrant and represent to the other that the representing party is not aware of any present and outstanding violations, defaults or breaches of the Lease by the other party, and each representing party has no known claims or offsets of any kind or nature against the other party, except as follows as of the date of this Amendment: (i) Lessee's first installment of 2013-1014 real property taxes for the Premises have not been paid.

15. Lease Continues in Full Force and Effect. Except as set forth in this Amendment, the Lease, as amended hereby, remains unmodified and continues in full force and effect in accordance with its terms.

16. Successor and Assigns. This Amendment shall be binding on Lessor's and Lessee's successors and assigns.

17. Counterparts. This Amendment may be executed in counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, Lessor and Lessee have executed this First Amendment as of the day and year first above written.

LESSOR:
HILLSIDE III LLC
A California Limited Liability Company
MID VALLEY PROPERTIES,
Managing Agent

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

By: /s/ Margaret Kestly
Margaret Kestly, Authorized Agent

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN

RENT CONCESSION AGREEMENT

This document shall set-forth the agreement of **HILLSIDE III LLC, a California Liability Company** Lessor, and **AEROVIRONMENT, INC., a Delaware Corporation**, Lessee concerning the Rent Concessions offered to Lessee in connection with that certain Lease dated **DECEMBER 1st, 2013** by and between Lessor and Lessee for the premises located at: **900 ENCHANTED WAY** City of **SIMI VALLEY**, State of California (the "Lease").

AS MATERIAL CONSIDERATION for the Rent Concession set-forth herein is Lessee's agreement to lease the Premises on the terms and provisions of the Lease for the entire Lease term. Lessee acknowledges that the Free Rent as set-forth below (herein called "Rent Concession") is a concession given to Lessee for leasing the Premises for the term stated in the First Amendment to Lease Agreement. In the event Lessee becomes in default of any material Lease provision at any time during the Lease term and has not cured such default within the applicable Notice and Cure periods in the lease, Lessor and Lessee agree that: (a) in addition to any other remedy available to Lessor, Lessor shall be entitled to recover from Lessee the unamortized rental amount of any received Rental Concessions taken by Lessee prior to such default date, (b) Lessee agrees to pay such amount to Lessor with the next rental payment. Lessee shall be entitled to the Free Rent and/or Rent Concession(s) provided below for the applicable period of time referenced below:

| | |
|---|---------------------|
| DECEMBER 1, 2013 THROUGH DECEMBER 31, 2013 | \$ 28,160.50 |
| JANUARY 1, 2014 THROUGH JANUARY 31, 2014 | \$ 56,321.00 |
| FEBRUARY 1, 2014 THROUGH FEBRUARY 28, 2014 | \$ 56,321.00 |
| MARCH 1, 2014 THROUGH MARCH 31, 2014 | \$ 56,321.00 |
| APRIL 1, 2014 THROUGH APRIL 30, 2014 | \$ 28,160.50 |
| MAY 1, 2014 THROUGH MAY 31, 2014 | \$ 28,160.50 |
| JUNE 1, 2014 THROUGH JUNE 30, 2014 | \$ 28,160.50 |
| NOVEMBER 1, 2014 THROUGH NOVEMBER 30, 2014 | \$ 28,160.50 |
| DECEMBER 1, 2014 THROUGH DECEMBER 31, 2014 | \$ 28,160.50 |
| JANUARY 1, 2015 THROUGH JANUARY 31, 2015 | \$ 28,160.50 |
| FEBRUARY 1, 2015 THROUGH FEBRUARY 28, 2015 | \$ 28,160.50 |
| MARCH 1, 2015 THROUGH MARCH 31, 2015 | \$ 28,160.50 |

No NNN as defined in the Lease shall be abated by the Rent Concession.

Rent Concession(s) referenced above equal a fair rental value in a sum as determined at the time the Rent Concession commences.

THIS DOCUMENT shall not be deemed binding upon Lessor unless and until it is executed by Lessor and a copy delivered to Lessee.

Dated this 18 day of December, 2013.

LESSOR:
HILLSIDE III LLC,
A California Limited Liability Company
By MID VALLEY PROPERTIES,
Managing Agent

BY: /s/ Margaret M. Kestly
Margaret M. Kestly, Authorized Agent

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN

OPTION TO RENEW

Tenant is granted one option to extend the lease for a period of Five (5) years commencing immediately after the expiration of the basic lease term. It shall be the obligation of the tenant to notify the Landlord of its intention to exercise its option to renew within the period between 270 days and 360 days prior to the day that the current lease expires. The notification of the intent to exercise its option shall be sent by tenant in writing by U.S. mail certified, overnight courier delivery or registered with return receipt requested.

The commencement rent for the first month of the option period shall be equal to comparable market rent for a similar building located within a ten-mile radius of the lease property giving consideration to all concessions, tenant improvement allowance and rental abatement for a non-renewal and non-sublease space. In analyzing the comparable building properties, the parties may take into account all factors including ceiling height, parking ratio, loading docks, loading doors and height/size of those doors, HVAC, office build out, electrical power and distribution, skylights, yard space, the general location and the view from inside the building.

Upon receipt within the time period spelled out above and the tenant's exercise of its option to extend said lease both parties will meet and confer in an attempt to arrive at the beginning rent during the option period. If the parties are not able to agree on the option period rent, each party shall designate a licensed real estate broker who has dealt with industrial property in the Simi Valley for not less than 5 years from the date of his appointment, and is at that time employed by an established real estate brokerage firm. If both brokers are unable to agree on the reasonable commencement rent for the option period, then both brokers will attempt to designate a third broker with qualifications at least as stringent as those required of the original brokers. Said third broker shall be given all of the material used by the original brokers to base their reasonable market value, and said broker shall make his own investigation. The third broker then shall select the opinion of one broker as the most correct value, and the value selected by said third broker shall be binding upon the parties.

If two original brokers cannot agree on a third broker, or if the third broker is unacceptable to the parties as defined herein, then either party may request that the presiding judge of the Superior Court of the County of Ventura select a commercial real estate broker from the list usually kept by said presiding judge, and said appointed brokers opinion shall be absolutely binding on all parties.

Any outside broker representing the tenant will receive a 2.5% commission for the option term, payable by Landlord.

If Lessee is in monetary default on the date of giving the option notice or at any time prior to the commencement of the renewal term, the option notice shall be totally ineffective and this Lease shall expire at the end of the initial term.

Notwithstanding the foregoing, the new Market Rent Value shall not be less than the rent payable for the month immediately preceding the rent adjustment.

Dated this 18 day of December, 2013.

LESSOR:
HILLSIDE III LLC
A California limited liability Company

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

By MID VALLEY PROPERTIES,
Managing Agent

BY: /s/ Margaret M. Kestly
Margaret M. Kestly, Authorized Agent

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN

**FIRST AMENDMENT TO LEASE AGREEMENT
(994 Flower Glen Street, Simi Valley, CA 93065)**

THIS FIRST AMENDMENT TO LEASE AGREEMENT (this "Amendment"), dated for reference purposes as of December 1, 2013, is entered into by and between **HILLSIDE ASSOCIATES II, LLC, a California Limited Liability Company** as Lessor, and **AEROVIRONMENT, INC, a Delaware Corporation**, as Lessee with reference to the following:

Recitals

A. Lessor and Lessee have entered into that certain AIR Commercial Real Estate Association Standard Industrial/Commercial Single Tenant Lease - Net, dated April 21, 2008, as addended (the "Lease") for that certain real property commonly known as 994 Flower Glen Street, Simi Valley, CA 93065, more particularly described therein. Each initially capitalized term not defined in this Amendment shall have the meaning ascribed to such term in the Lease. Each sectional reference below shall mean and refer to the applicable paragraph of the Lease.

B. Lessor and Lessee desire and intend to amend the Lease on the terms and conditions set forth hereinbelow.

NOW, THEREFORE, in consideration of the terms and provisions contained herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Lessor and Lessee hereby amend the Lease as follows:

1. Term. Paragraph 1.3 is hereby amended to provide that the Term of the Lease is extended for eight (8) years, commencing on December 1, 2013 and expiring on November 30, 2021 (the "Expiration Date").

2. Base Rent. Lessee agrees to pay Base Rent for the Premises during the extended term of the Lease, in advance, at such places as may be designated from time-to-time by Lessor, without deduction or offset, in the following amounts:

(i) From **DECEMBER 1, 2013 through NOVEMBER 30, 2015**: monthly installments of **\$29,368.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease;

(ii) From **DECEMBER 1, 2015 through NOVEMBER 30, 2017**: monthly installments of **\$30,690.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease;

(iii) From **DECEMBER 1, 2017 through NOVEMBER 30, 2019**: monthly installments of **\$32,071.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease; and

(iv) From **DECEMBER 1, 2019 THROUGH NOVEMBER 30, 2021**: monthly installments of **\$33,514.00**, together with such other assessments, additions and pass-throughs as are set forth in the Lease.

3. Base Rent Partial Limited Abatement. Provided Lessee shall not be in material default of the Lease, after any applicable notice and cure periods, immediately prior to or during any Base Rent partial abatement period, as provided below, the Base Rent payable by Lessee to Lessor for the Premises, as provided in Paragraph 2 of this Amendment above, shall be partially abated to the extent provided and during the periods provided in that certain Rental Concession Agreement attached hereto.

4. Security Deposit. Lessor and Lessee acknowledge and agree that Lessor holds the sum of **ZERO** and no/100 (**\$0.00**) Dollars as Security Deposit previously received pursuant to Paragraph 5 of the Lease and Lessor shall have no liability to Lessee for the return of any Security Deposit to Lessee upon the expiration or termination of the Lease.

5. Maintenance and Repairs. Paragraph 7 is hereby amended to provide that Lessee shall be obligated to manage and contract directly for services related to Lessee's obligations to maintain the Premises, including, but not limited to, all utilities and janitorial service. Lessor shall be responsible, at Lessor's sole cost and expense, for that portion of roof replacement and future roof repair cost which exceeds \$1,000 per occurrence, per building. Lessee shall be responsible, at Lessee's sole cost and expense, for the first \$1,000 of roof replacement and future roof repair cost not payable by Lessor above. A roof assessment of the Premises shall be performed by a licensed roofing contractor. All roofing replacement and/or repair work shall be performed to applicable governmental code requirements, within one hundred and twenty (120) days of lease execution weather permitting.

6. Tax Protest. During the lease term, Lessee shall be entitled, at its election, to file a protest with the Ventura County Tax Assessor's Office to reduce the real property taxes to reflect the current valuation of the Property.

7. Exterior Windows and Doors. Prior to January 31st, 2014, subject to such extension of additional time as may be required due to weather, Lessor, at Lessor's sole cost and expense, shall repair and re-seal all exterior windows and doors of the Premises in a workman-like and professional manner, as may be required. Lessee shall maintain all exterior windows and doors of the Premises throughout Term of the Lease.

8. HVAC. Lessor and Lessee agree that, within a commercially reasonable time, upon mutual agreement of Lessor and Lessee, the HVAC units of the Premises that have exceeded their useful life and any other HVAC major components (such as compressors, fans, etc.) that fail, for reasons other than failure of Lessee to maintain such HVAC major components, during the extended Term of the Lease (collectively, the "HVAC Work") shall be repaired or replaced, as may be required, subject to the cost allocation provided below. Lessee shall not perform any of the HVAC Work without Lessor's prior approval of the work to be done and the estimated cost of such work. The cost of such HVAC Work shall be borne 50% by Lessor and 50% by Lessee and Lessee's share of such cost shall be payable by Lessee upon demand by Lessor. In lieu of paying to Lessor its 50% share of the cost of the HVAC work, Lessee shall be entitled to apply its Base Rent partial abatement or any portion thereof during the twelfth (12th) through the sixteenth (16th) months of the Term of this Lease, as provided in Paragraph 3 of this Amendment above and the attached Rental Concession Agreement, to satisfy its obligation for its share of such HVAC Work and, in the event of such election by Lessee, the amount of such Base Rent partial abatement shall be reduced by the amount of Lessee's share of the HVAC Work so applied (Base rent is not increased and remains the same. Lessee is just not entitled to offset cost of HVAC work as rent concession since Lessee did not pay). Notwithstanding the foregoing, Lessee shall maintain all HVAC units and HVAC major components during the Term through a service contract with Lessor's approved HVAC vendor.

9. Parking Area. Lessor shall, within twelve (12) months of lease execution weather permitting (such work to be done during daylight savings time) slurry coat and restripe the parking areas of the Property, at Lessor's sole cost and expense, on non-work days (Saturdays and Sundays).

10. Rental Refund Payment. Promptly after mutual execution of this Amendment, Lessor agrees to refund to Lessee Base Rent paid by Lessee for the Premises during 2013 in the amount of \$114,720.00.

11. Option to Extend Term. Lessee shall have one (1) option to extend the Term for sixty (60) months on the terms and subject to the conditions provided in the attached Option to Renew.

12. Street Privatization. Lessor agrees to cooperate with the City of Simi Valley with respect to the privatization of Enchanted Way/Flower Glen Street. Lessee shall be responsible for obtaining all approvals and permits necessary for such privatization, at Lessee's sole cost and expense. If Enchanted Way/Flower Glen Street are successfully privatized, Lessee shall be responsible for all maintenance of such privatized street(s), at Lessee's sole cost and expense during the lease term.

13. Non-Disturbance Agreement. Lessor and Lessee acknowledge their respective rights and obligations under Paragraph 30.3 regarding Non-Disturbance Agreements

14. Warranty. Lessor and Lessee each warrant and represent to the other that the representing party is not aware of any present and outstanding violations, defaults or breaches of the Lease by the other party, and each representing party has no known claims or offsets of any kind or nature against the other party, except as follows as of the date of this Amendment: (i) Lessee's first installment of 2013-1014 real property taxes for the Premises have not been paid.

15. Lease Continues in Full Force and Effect. Except as set forth in this Amendment, the Lease, as amended hereby, remains unmodified and continues in full force and effect in accordance with its terms.

16. Successor and Assigns. This Amendment shall be binding on Lessor's and Lessee's successors and assigns.

17. Counterparts. This Amendment may be executed in counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, Lessor and Lessee have executed this First Amendment as of the day and year first above written.

LESSOR:
HILLSIDE ASSOCIATES II, LLC
A California Limited Liability Company
MID VALLEY PROPERTIES,
Managing Agent

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

By: /s/ Margaret Kestly
Margaret Kestly, Authorized Agent

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN

RENT CONCESSION AGREEMENT

This document shall set-forth the agreement of **HILLSIDE ASSOCIATES II, LLC** a California Liability Company Lessor, and **AEROVIRONMENT, INC., a Delaware Corporation**, Lessee concerning the Rent Concessions offered to Lessee in connection with that certain Lease dated **DECEMBER 1st, 2013** by and between Lessor and Lessee for the premises located at: **994 FLOWER GLEN STREET** City of **SIMI VALLEY**, State of California (the "Lease").

AS MATERIAL CONSIDERATION for the Rent Concession set-forth herein is Lessee's agreement to lease the Premises on the terms and provisions of the Lease for the entire Lease term. Lessee acknowledges that the Free Rent as set-forth below (herein called "Rent Concession") is a concession given to Lessee for leasing the Premises for the term stated in the First Amendment to Lease Agreement. In the event Lessee becomes in default of any material Lease provision at any time during the Lease term and has not cured such default within the applicable Notice and Cure periods in the lease, Lessor and Lessee agree that: (a) in addition to any other remedy available to Lessor, Lessor shall be entitled to recover from Lessee the unamortized rental amount of any received Rental Concessions taken by Lessee prior to such default date, (b) Lessee agrees to pay such amount to Lessor with the next rental payment. Lessee shall be entitled to the Free Rent and/or Rent Concession(s) provided below for the applicable period of time referenced below:

| | |
|---|---------------------|
| DECEMBER 1, 2013 THROUGH DECEMBER 31, 2013 | \$ 14,684.00 |
| JANUARY 1, 2014 THROUGH JANUARY 31, 2014 | \$ 29,368.00 |
| FEBRUARY 1, 2014 THROUGH FEBRUARY 28, 2014 | \$ 29,368.00 |
| MARCH 1, 2014 THROUGH MARCH 31, 2014 | \$ 29,368.00 |
| APRIL 1, 2014 THROUGH APRIL 30, 2014 | \$ 14,684.00 |
| MAY 1, 2014 THROUGH MAY 31, 2014 | \$ 14,684.00 |
| JUNE 1, 2014 THROUGH JUNE 30, 2014 | \$ 14,684.00 |
| NOVEMBER 1, 2014 THROUGH NOVEMBER 30, 2014 | \$ 14,684.00 |
| DECEMBER 1, 2014 THROUGH DECEMBER 31, 2014 | \$ 14,684.00 |
| JANUARY 1, 2015 THROUGH JANUARY 31, 2015 | \$ 14,684.00 |
| FEBRUARY 1, 2015 THROUGH FEBRUARY 28, 2015 | \$ 14,684.00 |
| MARCH 1, 2015 THROUGH MARCH 31, 2015 | \$ 14,684.00 |

No NNN as defined in the Lease shall be abated by the Rent Concession.

Rent Concession(s) referenced above equal a fair rental value in a sum as determined at the time the Rent Concession commences.

THIS DOCUMENT shall not be deemed binding upon Lessor unless and until it is executed by Lessor and a copy delivered to Lessee.

Dated this 18 day of December, 2013.

LESSOR:
HILLSIDE ASSOCIATES II, LLC
A California Limited Liability Company
By MID VALLEY PROPERTIES,
Managing Agent

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

BY: /s/ Margaret M. Kestly
Margaret M. Kestly, Authorized Agent

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN

OPTION TO RENEW

Tenant is granted one option to extend the lease for a period of Five (5) years commencing immediately after the expiration of the basic lease term. It shall be the obligation of the tenant to notify the Landlord of its intention to exercise its option to renew within the period between 270 days and 360 days prior to the day that the current lease expires. The notification of the intent to exercise its option shall be sent by tenant in writing by U.S. mail certified, overnight courier delivery or registered with return receipt requested.

The commencement rent for the first month of the option period shall be equal to comparable market rent for a similar building located within a ten-mile radius of the lease property giving consideration to all concessions, tenant improvement allowance and rental abatement for a non-renewal and non-sublease space. In analyzing the comparable building properties, the parties may take into account all factors including ceiling height, parking ratio, loading docks, loading doors and height/size of those doors, HVAC, office build out, electrical power and distribution, skylights, yard space, the general location and the view from inside the building.

Upon receipt within the time period spelled out above and the tenant's exercise of its option to extend said lease both parties will meet and confer in an attempt to arrive at the beginning rent during the option period. If the parties are not able to agree on the option period rent, each party shall designate a licensed real estate broker who has dealt with industrial property in the Simi Valley for not less than 5 years from the date of his appointment, and is at that time employed by an established real estate brokerage firm. If both brokers are unable to agree on the reasonable commencement rent for the option period, then both brokers will attempt to designate a third broker with qualifications at least as stringent as those required of the original brokers. Said third broker shall be given all of the material used by the original brokers to base their reasonable market value, and said broker shall make his own investigation. The third broker then shall select the opinion of one broker as the most correct value, and the value selected by said third broker shall be binding upon the parties.

If two original brokers cannot agree on a third broker, or if the third broker is unacceptable to the parties as defined herein, then either party may request that the presiding judge of the Superior Court of the County of Ventura select a commercial real estate broker from the list usually kept by said presiding judge, and said appointed brokers opinion shall be absolutely binding on all parties.

Any outside broker representing the tenant will receive a 2.5% commission for the option term, payable by Landlord.

If Lessee is in monetary default on the date of giving the option notice or at any time prior to the commencement of the renewal term, the option notice shall be totally ineffective and this Lease shall expire at the end of the initial term.

Notwithstanding the foregoing, the new Market Rent Value shall not be less than the rent payable for the month immediately preceding the rent adjustment.

Dated this 18 day of December, 2013.

LESSOR:
HILLSIDE ASSOCIATES II, LLC
A California limited liability Company

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

By MID VALLEY PROPERTIES,
Managing Agent

BY: /s/ Margaret M. Kestly
Margaret M. Kestly, Authorized Agent

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN



AIR COMMERCIAL REAL ESTATE ASSOCIATION
STANDARD INDUSTRIAL/COMMERCIAL SINGLE-TENANT LEASE -- NET
(DO NOT USE THIS FORM FOR MULTI-TENANT BUILDINGS)

1. Basic Provisions ("Basic Provisions").

1.1 Parties: This Lease ("Lease"), dated for reference purposes only DECEMBER 12, 2013
is made by and between HILLSIDE ASSOCIATES II, LLC ("Lessor")
and AEROVIRONMENT, INC., A DELAWARE CORPORATION ("Lessee").

(collectively the "Parties," or individually a "Party").

1.2 Premises: That certain real property, including all improvements therein or to be provided by Lessor under the terms of this Lease,
and commonly known as 996 FLOWER GLEN STREET, SIMI VALLEY
located in the County of VENTURA, State of CALIFORNIA
and generally described as (describe briefly the nature of the property and, if applicable, the "Project", if the property is located within a Project)
FREE STANDING SINGLE STORY 43,008 SQUARE FOOT BUILDING LOCATED WITHIN THE HILLSIDE
INDUSTRIAL CENTER PROJECT *SEE PARAGRAPH #2 OF ADDENDUM

1.3 Term: EIGHT (8) years and ZERO (0) months ("Original Term") commencing DECEMBER 1, 2013
("Commencement Date") and ending NOVEMBER 30, 2021 ("Expiration Date"). (See also Paragraph 3)

1.4 Early Possession: N/A ("Early Possession Date").
(See also Paragraphs 3.2 and 3.3)

1.5 Base Rent: \$27,525.00 per month ("Base Rent"), payable on the FIRST day of
each month commencing DECEMBER 1, 2013

(See also Paragraph 4)

□ If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted.

1.6 Base Rent and Other Monies Paid Upon Execution:

(a) Base Rent: \$13,762.50 for the period DEC. 1, 2013 THROUGH DEC. 31, 2013

(b) Security Deposit: \$0.00 ("Security Deposit"). (See also Paragraph 5)

(c) Association Fees: \$N/A for the period N/A

(d) Other: \$N/A for N/A

(e) Total Due Upon Execution of this Lease: \$13,762.50

1.7 Agreed Use: OFFICE & WAREHOUSE FOR LIGHT MANUFACTURING (See also Paragraph 6)

1.8 Insuring Party: Lessor is the "Insuring Party" unless otherwise stated herein. (See also Paragraph 5)

1.9 Real Estate Brokers: (See also Paragraph 15)

(a) Representation: The following real estate brokers (the "Brokers") and brokerage relationships exist in this transaction (check
applicable boxes):

- represents Lessor exclusively ("Lessor's Broker");
☑ JOSEF FARRAR/NEWMARK GRUBB KNIGHT FRANK (NCKF) represents Lessee exclusively ("Lessee's Broker"); or
□ represents both Lessor and Lessee ("Dual Agency").

(b) Payment to Brokers: Upon execution and delivery of this Lease by both Parties, Lessor shall pay to the Broker the fee agreed to
in their separate written agreement (or if there is no such agreement, the sum of PER AGREEMENT or % of the total Base Rent)
for the brokerage services rendered by the Brokers.

1.10 Guarantor. The obligations of the Lessee under this Lease are to be guaranteed by N/A ("Guarantor"). (See also Paragraph 37)

1.11 Attachments. Attached hereto are the following, all of which constitute a part of this Lease:

- ☑ an Addendum consisting of Paragraphs 1 through 2;
□ a plot plan depicting the Premises;
□ a current set of the Rules and Regulations;
□ a Work Letter;
□ other (specify): RENT ADJUSTMENT, RENT CONCESSION AGREEMENT, ADDENDUM, ATTACHMENT, OPTION TO RENEW

2. Premises.

2.1 Letting. Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and
upon all of the terms, covenants and conditions set forth in this Lease. Unless otherwise provided herein, any statement of size set forth in this Lease,

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or that may have been used in calculating Rent, is an approximation which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less. Note: Lessee is advised to verify the actual size prior to executing this Lease.

2.2 **Condition.** Lessor shall deliver the Premises to Lessee broom clean and free of debris on the Commencement Date or the Early Possession Date, whichever first occurs ("Start Date"), and, so long as the required service contracts described in Paragraph 7.1(b) below are obtained by Lessee and in effect within thirty days following the Start Date, warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems ("HVAC"), loading doors, sump pumps, if any, and all other such elements in the Premises, other than those constructed by Lessee, shall be in good operating condition on said date, that the structural elements of the roof, bearing walls and foundation of any buildings on the Premises (the "Building") shall be free of material defects, and that the Premises do not contain hazardous levels of any mold or fungi defined as toxic under applicable state or federal law. If a non-compliance with said warranty exists as of the Start Date, or if one of such systems or elements should malfunction or fail within the appropriate warranty period, Lessor shall, as Lessor's sole obligation with respect to such matter, except as otherwise provided in this Lease, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, malfunction or failure, rectify same at Lessor's expense. The warranty periods shall be as follows: (i) 6 months as to the HVAC systems, and (ii) 30 days as to the remaining systems and other elements of the Building. If Lessee does not give Lessor the required notice within the appropriate warranty period, correction of any such non-compliance, malfunction or failure shall be the obligation of Lessee at Lessee's sole cost and expense.

2.3 **Compliance.** Lessor warrants that to the best of its knowledge the improvements on the Premises comply with the building codes, applicable laws, covenants or restrictions of record, regulations, and ordinances ("Applicable Requirements") that were in effect at the time that each improvement, or portion thereof, was constructed. Said warranty does not apply to the use to which Lessee will put the Premises, modifications which may be required by the Americans with Disabilities Act or any similar laws as a result of Lessee's use (see Paragraph 50), or to any Alterations or Utility Installations (as defined in Paragraph 7.3(a)) made or to be made by Lessee. NOTE: Lessee is responsible for determining whether or not the Applicable Requirements, and especially the zoning, are appropriate for Lessee's intended use, and acknowledges that past uses of the Premises may no longer be allowed. If the Premises do not comply with said warranty, Lessor shall, except as otherwise provided, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, rectify the same at Lessor's expense. If Lessee does not give Lessor written notice of a non-compliance with this warranty within 6 months following the Start Date, correction of that non-compliance shall be the obligation of Lessee at Lessee's sole cost and expense. If the Applicable Requirements are hereafter changed so as to require during the term of this Lease the construction of an addition to or an alteration of the Premises and/or Building, the remediation of any Hazardous Substance, or the reinforcement or other physical modification of the Unit, Premises and/or Building ("Capital Expenditure"), Lessor and Lessee shall allocate the cost of such work as follows:

(a) Subject to Paragraph 2.3(c) below, if such Capital Expenditures are required as a result of the specific and unique use of the Premises by Lessee as compared with uses by tenants in general, Lessee shall be fully responsible for the cost thereof, provided, however that if such Capital Expenditure is required during the last 2 years of this Lease and the cost thereof exceeds 6 months' Base Rent, Lessee may instead terminate this Lease unless Lessor notifies Lessee, in writing, within 10 days after receipt of Lessee's termination notice that Lessor has elected to pay the difference between the actual cost thereof and an amount equal to 6 months' Base Rent. If Lessee elects termination, Lessee shall immediately cease the use of the Premises which requires such Capital Expenditure and deliver to Lessor written notice specifying a termination date at least 90 days thereafter. Such termination date shall, however, in no event be earlier than the last day that Lessee could legally utilize the Premises without commencing such Capital Expenditure.

(b) If such Capital Expenditure is not the result of the specific and unique use of the Premises by Lessee (such as, governmentally mandated seismic modifications), then Lessor shall pay for such Capital Expenditure and Lessee shall only be obligated to pay, each month during the remainder of the term of this Lease, on the date that on which the Base Rent is due, an amount equal to 144th of the portion of such costs reasonably attributable to the Premises. Lessee shall pay interest on the balance but may prepay its obligation at any time. If, however, such Capital Expenditure is required during the last 2 years of this Lease or if Lessor reasonably determines that it is not economically feasible to pay its share thereof, Lessor shall have the option to terminate this Lease upon 90 days prior written notice to Lessee unless Lessee notifies Lessor, in writing, within 10 days after receipt of Lessor's termination notice that Lessee will pay for such Capital Expenditure. If Lessor does not elect to terminate, and fails to tender its share of any such Capital Expenditure, Lessee may advance such funds and deduct same, with interest, from Rent until Lessor's share of such costs have been fully paid. If Lessee is unable to finance Lessor's share, or if the balance of the Rent due and payable for the remainder of this Lease is not sufficient to fully reimburse Lessee on an offset basis, Lessee shall have the right to terminate this Lease upon 30 days written notice to Lessor.

(c) Notwithstanding the above, the provisions concerning Capital Expenditures are intended to apply only to non-voluntary, unexpected, and new Applicable Requirements. If the Capital Expenditures are instead triggered by Lessee as a result of an actual or proposed change in use, change in intensity of use, or modification to the Premises then, and in that event, Lessee shall either: (i) immediately cease such change in use or intensity of use and/or take such other steps as may be necessary to eliminate the requirement for such Capital Expenditure, or (ii) complete such Capital Expenditure at its own expense. Lessee shall not, however, have any right to terminate this Lease.

2.4 **Acknowledgements.** Lessee acknowledges that: (a) it has been advised by Lessor and/or Brokers to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements and the Americans with Disabilities Act), and their suitability for Lessee's intended use, (b) Lessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises, and (c) neither Lessor, Lessor's agents, nor Brokers have made any oral or written representations or warranties with respect to said matters other than as set forth in this Lease. In addition, Lessor acknowledges that: (i) Brokers have made no representations, promises or warranties concerning Lessee's ability to honor the Lease or suitability to occupy the Premises, and (ii) it is Lessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

2.5 **Lessee as Prior Owner/Occupant.** The warranties made by Lessor in Paragraph 2 shall be of no force or effect if immediately prior to the Start Date Lessee was the owner or occupant of the Premises. In such event, Lessee shall be responsible for any necessary corrective work.

3. **Term.**

- 3.1 **Term.** The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.
3.2 **Early Possession.** If Lessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay

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Base Rent shall be abated for the period of such early possession. All other terms of this Lease (including but not limited to the obligations to pay Real Property Taxes and insurance premiums and to maintain the Premises) shall be in effect during such period. Any such early possession shall not affect the Expiration Date.

3.3 **Delay in Possession.** Lessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises to Lessee by the Commencement Date. If, despite said efforts, Lessor is unable to deliver possession by such date, Lessor shall not be subject to any liability therefor, nor shall such failure affect the validity of this Lease. Lessee shall not, however, be obligated to pay Rent or perform its other obligations until Lessor delivers possession of the Premises and any period of rent abatement that Lessee would otherwise have enjoyed shall run from the date of delivery of possession and continue for a period equal to what Lessee would otherwise have enjoyed under the terms hereof, but minus any days of delay caused by the acts or omissions of Lessee. If possession is not delivered within 60 days after the Commencement Date, Lessee may, at its option, by notice in writing within 10 days after the end of such 60 day period, cancel this Lease, in which event the Parties shall be discharged from all obligations hereunder. If such written notice is not received by Lessor within said 10 day period, Lessee's right to cancel shall terminate. If possession of the Premises is not delivered within 120 days after the Commencement Date, this Lease shall terminate unless other agreements are reached between Lessor and Lessee, in writing.

3.4 **Lessee Compliance.** Lessor shall not be required to deliver possession of the Premises to Lessee until Lessee complies with its obligation to provide evidence of insurance (Paragraph 8.5). Pending delivery of such evidence, Lessee shall be required to perform all of its obligations under this Lease from and after the Start Date, including the payment of Rent, notwithstanding Lessor's election to withhold possession pending receipt of such evidence of insurance. Further, if Lessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Lessor may elect to withhold possession until such conditions are satisfied.

4. **Rent.**

4.1 **Rent Defined.** All monetary obligations of Lessee to Lessor under the terms of this Lease (except for the Security Deposit) are deemed to be rent ("Rent").

4.2 **Payment.** Lessee shall cause payment of Rent to be received by Lessor in lawful money of the United States, without offset or deduction (except as specifically permitted in this Lease), on or before the day on which it is due. All monetary amounts shall be rounded to the nearest whole dollar. In the event that any invoice prepared by Lessor is inaccurate such inaccuracy shall not constitute a waiver and Lessee shall be obligated to pay the amount set forth in this Lease. Rent for any period during the term hereof which is for less than one full calendar month shall be prorated based upon the actual number of days of said month. Payment of Rent shall be made to Lessor at its address stated herein or to such other persons or place as Lessor may from time to time designate in writing. Acceptance of a payment which is less than the amount then due shall not be a waiver of Lessor's rights to the balance of such Rent, regardless of Lessor's endorsement of any check so stating. In the event that any check, draft, or other instrument of payment given by Lessee to Lessor is dishonored for any reason, Lessee agrees to pay to Lessor the sum of \$25 in addition to any Late Charge and Lessor, at its option, may require all future Rent be paid by cashier's check. Payments will be applied first to accrued late charges and attorney's fees, second to accrued interest, then to Base Rent and Common Area Operating Expenses, and any remaining amount to any other outstanding charges or costs.

4.3 **Association Fees.**—In addition to the Base Rent, Lessee shall pay to Lessor each month an amount equal to any owner's association or condominium fees levied or assessed against the Premises. Said monies shall be paid at the same time and in the same manner as the Base Rent.

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5. **Security Deposit.** Lessee shall deposit with Lessor upon execution hereof the Security Deposit as security for Lessee's faithful performance of its obligations under this Lease. If Lessee fails to pay Rent, or otherwise Defaults under this Lease, Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount due already due Lessor, for Rents which will be due in the future, and/ or to reimburse or compensate Lessor for any liability, expense, loss or damage which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of the Security Deposit, Lessee shall within 10 days after written request therefor deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. If the Base Rent increases during the term of this Lease, Lessee shall, upon written request from Lessor, deposit additional monies with Lessor so that the total amount of the Security Deposit shall at all times bear the same proportion to the increased Base Rent as the initial Security Deposit bore to the initial Base Rent. Should the Agreed Use be amended to accommodate a material change in the business of Lessee or to accommodate a sublessee or assignee, Lessor shall have the right to increase the Security Deposit to the extent necessary, in Lessor's reasonable judgment, to account for any increased wear and tear that the Premises may suffer as a result thereof. If a change in control of Lessee occurs during this Lease and following such change the financial condition of Lessee is, in Lessor's reasonable judgment, significantly reduced, Lessee shall deposit such additional monies with Lessor as shall be sufficient to cause the Security Deposit to be at a commercially reasonable level based on such change in financial condition. Lessor shall not be required to keep the Security Deposit separate from its general accounts. ~~Within 90 days after the expiration or termination of this Lease, Lessor shall return that portion of the Security Deposit not used or applied by Lessor. No part of the Security Deposit shall be considered to be held in trust, to bear interest or to be prepayment for any monies to be paid by Lessee under this Lease.~~

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6. **Use.**

6.1 **Use.** Lessee shall use and occupy the Premises only for the Agreed Use, or any other legal use which is reasonably comparable thereto, and for no other purpose. Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates damage, waste or a nuisance, or that disturbs occupants of or causes damage to neighboring premises or properties. Other than guide, signal and seeing eye dogs, Lessee shall not keep or allow in the Premises any pets, animals, birds, fish, or reptiles. Lessor shall not unreasonably withhold or delay its consent to any written request for a modification of the Agreed Use, so long as the same will not impair the structural integrity of the improvements on the Premises or the mechanical or electrical systems therein, and/or is not significantly more burdensome to the Premises. If Lessor elects to withhold consent, Lessor shall within 7 days after such request give written notification of same, which notice shall include an explanation of Lessor's objections to the change in the Agreed Use.

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6.2 Hazardous Substances.

(a) **Reportable Uses Require Consent.** The term "Hazardous Substance" as used in this Lease shall mean any product, substance, or waste whose presence, use, manufacture, disposal, transportation, or release, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment or the Premises, (ii) regulated or monitored by any governmental authority, or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substances shall include, but not be limited to, hydrocarbons, petroleum, gasoline, and/or crude oil or any products, by-products or fractions thereof. Lessee shall not engage in any activity in or on the Premises which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor and timely compliance (at Lessee's expense) with all Applicable Requirements. "Reportable Use" shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority, and/or (iii) the presence at the Premises of a Hazardous Substance with respect to which any Applicable Requirements requires that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Lessee may use any ordinary and customary materials reasonably required to be used in the normal course of the Agreed Use, ordinary office supplies (copier toner, liquid paper, glue, etc.) and common household cleaning materials, so long as such use is in compliance with all Applicable Requirements, is not a Reportable Use, and does not expose the Premises or neighboring property to any meaningful risk of contamination or damage or expose Lessor to any liability therefor. In addition, Lessor may condition its consent to any Reportable Use upon receiving such additional assurances as Lessor reasonably deems necessary to protect itself, the public, the Premises and/or the environment against damage, contamination, injury and/or liability, including, but not limited to, the installation (and removal on or before Lease expiration or termination) of protective modifications (such as concrete encasements) and/or increasing the Security Deposit.

(b) **Duty to Inform Lessor.** If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises, other than as previously consented to by Lessor, Lessee shall immediately give written notice of such fact to Lessor, and provide Lessor with a copy of any report, notice, claim or other documentation which it has concerning the presence of such Hazardous Substance.

(c) **Lessee Remediation.** Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on, under, or about the Premises (including through the plumbing or sanitary sewer system) and shall promptly, at Lessee's expense, comply with all Applicable Requirements and take all investigatory and/or remedial action reasonably recommended, whether or not formally ordered or required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of the Premises or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance brought onto the Premises during the term of this Lease, by or for Lessee, or any third party.

(d) **Lessee Indemnification.** Lessee shall indemnify, defend and hold Lessor, its agents, employees, lenders and ground lessor, if any, harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee, or any third party (provided, however, that Lessee shall have no liability under this Lease with respect to underground migration of any Hazardous Substance under the Premises from adjacent properties not caused or contributed to by Lessee). Lessee's obligations shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease. No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically so agreed by Lessor in writing at the time of such agreement.

(e) **Lessor Indemnification.** Lessor and its successors and assigns shall indemnify, defend, reimburse and hold Lessee, its employees and lenders, harmless from and against any and all environmental damages, including the cost of remediation, which result from Hazardous Substances which existed on the Premises prior to Lessee's occupancy or which are caused by the gross negligence or willful misconduct of Lessor, its agents or employees. Lessor's obligations, as and when required by the Applicable Requirements, shall include, but not be limited to, the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease.

(f) **Investigations and Remediations.** Lessor shall retain the responsibility and pay for any investigations or remediation measures required by governmental entities having jurisdiction with respect to the existence of Hazardous Substances on the Premises prior to Lessee's occupancy, unless such remediation measure is required as a result of Lessee's use (including "Alterations", as defined in paragraph 7.3(a) below) of the Premises, in which event Lessee shall be responsible for such payment. Lessee shall cooperate fully in any such activities at the request of Lessor, including allowing Lessor and Lessor's agents to have reasonable access to the Premises at reasonable times in order to carry out Lessor's investigative and remedial responsibilities.

(g) **Lessor Termination Option.** If a Hazardous Substance Condition (see Paragraph 9.1(e)) occurs during the term of this Lease, unless Lessee is legally responsible therefor (in which case Lessee shall make the investigation and remediation thereof required by the Applicable Requirements and this Lease shall continue in full force and effect, but subject to Lessor's rights under Paragraph 6.2(d) and Paragraph 13), Lessor may, at Lessor's option, either (i) investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) if the estimated cost to remediate such condition exceeds 12 times the then monthly Base Rent or \$100,000, whichever is greater, give written notice to Lessee, within 30 days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition, of Lessor's desire to terminate this Lease as of the date 60 days following the date of such notice. In the event Lessor elects to give a termination notice, Lessee may, within 10 days thereafter, give written notice to Lessor of Lessee's commitment to pay the amount by which the cost of the remediation of such Hazardous Substance Condition exceeds an amount equal to 12 times the then monthly Base Rent or \$100,000, whichever is greater. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days following such commitment. In such event, this Lease shall continue in full force and effect, and Lessor shall proceed to make such remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time provided, this Lease shall terminate as of the date specified in Lessor's notice of termination.

6.3 **Lessee's Compliance with Applicable Requirements.** Except as otherwise provided in this Lease, Lessee shall, at Lessee's sole expense, fully, diligently and in a timely manner, materially comply with all Applicable Requirements, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants which relate in any manner to the such

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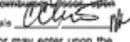
Requirements, without regard to whether such Requirements are now in effect or become effective after the Start Date. Lessee shall, within 10 days after receipt of Lessor's written request, provide Lessor with copies of all permits and other documents, and other information evidencing Lessee's compliance with any Applicable Requirements specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or involving the failure of Lessee or the Premises to comply with any Applicable Requirements. Likewise, Lessee shall immediately give written notice to Lessor of: (i) any water damage to the Premises and any suspected seepage, pooling, dampness or other condition conducive to the production of mold; or (ii) any mustiness or other odors that might indicate the presence of mold in the Premises.

6.4 **Inspection; Compliance.** Lessor and Lessor's "Lender" (as defined in Paragraph 30) and consultants shall have the right to enter into Premises at any time, in the case of an emergency, and otherwise at reasonable times after reasonable notice, for the purpose of inspecting the condition of the Premises and for verifying compliance by Lessee with this Lease. The cost of any such inspections shall be paid by Lessor, unless a violation of Applicable Requirements, or a Hazardous Substance Condition (see paragraph 9.1) is found to exist or be imminent, or the inspection is requested or ordered by a governmental authority. In such case, Lessee shall upon request reimburse Lessor for the cost of such inspection, so long as such inspection is reasonably related to the violation or contamination. In addition, Lessee shall provide copies of all relevant material safety data sheets (MSDS) to Lessor within 10 days of the receipt of a written request therefor.

7. **Maintenance; Repairs; Utility Installations; Trade Fixtures and Alterations.**

7.1 **Lessee's Obligations.**

(a) **In General.** Subject to the provisions of Paragraph 2.2 (Condition), 2.3 (Compliance), 6.3 (Lessee's Compliance with Applicable Requirements), 7.2 (Lessor's Obligations), 9 (Damage or Destruction), and 14 (Condemnation), Lessee shall, at Lessee's sole expense, keep the Premises, Utility Installations (intended for Lessee's exclusive use, no matter where located), and Alterations in good order, condition and repair (whether or not the portion of the Premises requiring repairs, or the means of repairing the same, are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use, the elements or the age of such portion of the Premises), including, but not limited to, all equipment or facilities, such as plumbing, HVAC equipment, electrical, lighting facilities, boilers, pressure vessels, fire protection system, fixtures, walls (interior and exterior), foundations, ceilings, roofs, roof drainage systems, floors, windows, doors, plate glass, skylights, landscaping, driveways, parking lots, fences, retaining walls, signs, sidewalks and parkways located in, on, or adjacent to the Premises. Lessee, in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices, specifically including the procurement and maintenance of the service contracts required by Paragraph 7.1(b) below. Lessee's obligations shall include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair. Lessee shall, during the term of this Lease, keep the exterior appearance of the Building in a first-class condition (including, e.g. graffiti removal) consistent with the exterior appearance of other similar facilities of comparable age and size in the vicinity, including, when necessary, the exterior repainting of the Building.

(b) **Service Contracts.** Lessee shall, at Lessee's sole expense, procure and maintain contracts, with copies to Lessor, in customary form and substance for, and with contractors specializing and experienced in the maintenance of the following equipment and improvements, if any, and when installed on the Premises: (i) HVAC equipment, (ii) boiler, and pressure vessels, (iii) fire extinguishing systems, including fire alarm and/or smoke detection, (iv) landscaping and irrigation systems, (v) roof covering and drains, and (vi) clarifiers. ~~However, Lessor reserves the right, upon notice to Lessee, to procure and maintain any or all of such service contracts, and Lessee shall reimburse Lessor, upon demand, for the cost thereof.~~ ^{Initials} 

(c) **Failure to Perform.** If Lessee fails to perform Lessee's obligations under this Paragraph 7.1, Lessor may enter upon the Premises after 10 days' prior written notice to Lessee (except in the case of an emergency, in which case no notice shall be required), perform such obligations on Lessee's behalf, and put the Premises in good order, condition and repair, and Lessee shall promptly pay to Lessor a sum equal to 115% of the cost thereof.

(d) **Replacement.** Subject to Lessee's indemnification of Lessor as set forth in Paragraph 8.7 below, and without relieving Lessee of liability resulting from Lessee's failure to exercise and perform good maintenance practices, if an item described in Paragraph 7.1(b) cannot be repaired other than at a cost which is in excess of 50% of the cost of replacing such item, then such item shall be replaced by Lessor, and the cost thereof shall be prorated between the Parties and Lessee shall only be obligated to pay, each month during the remainder of the term of this Lease, on the date on which Base Rent is due, an amount equal to the product of multiplying the cost of such replacement by a fraction, the numerator of which is one, and the denominator of which is 144 (i.e. 1/144th of the cost per month). Lessee shall pay interest on the unamortized balance but may prepay its obligation at any time.

7.2 **Lessor's Obligations.** Subject to the provisions of Paragraphs 2.2 (Condition), 2.3 (Compliance), 9 (Damage or Destruction) and 14 (Condemnation), it is intended by the Parties hereto that Lessor have no obligation, in any manner whatsoever, to repair and maintain the Premises, or the equipment therein, all of which obligations are intended to be that of the Lessee. It is the intention of the Parties that the terms of this Lease govern the respective obligations of the Parties as to maintenance and repair of the Premises, and they expressly waive the benefit of any statute now or hereafter in effect to the extent it is inconsistent with the terms of this Lease.

7.3 **Utility Installations; Trade Fixtures; Alterations.**

(a) **Definitions.** The term "Utility Installations" refers to all floor and window coverings, air and/or vacuum lines, power panels, electrical distribution, security and fire protection systems, communication cabling, lighting fixtures, HVAC equipment, plumbing, and fencing in or on the Premises. The term "Trade Fixtures" shall mean Lessee's machinery and equipment that can be removed without doing material damage to the Premises. The term "Alterations" shall mean any modification of the improvements, other than Utility Installations or Trade Fixtures, whether by addition or deletion. "Lessee Owned Alterations and/or Utility Installations" are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor pursuant to Paragraph 7.4(a).

(b) **Consent.** Lessee shall not make any Alterations or Utility Installations to the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Utility Installations to the interior of the Premises (excluding the roof) without such consent but upon notice to Lessor, as long as they are not visible from the outside, do not involve puncturing, relocating or removing the roof or any existing walls, will not affect the electrical, plumbing, HVAC, and/or life safety systems, and the cumulative cost thereof during this Lease as extended does not exceed a sum equal to 3 months' Base Rent in the aggregate or a sum equal to one month's Base Rent in any one year. Notwithstanding the foregoing, Lessee shall not

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make or permit any roof penetrations and/or install anything on the roof without the prior written approval of Lessor. Lessor may, as a precondition to granting such approval, require Lessee to utilize a contractor chosen and/or approved by Lessor. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. Consent shall be deemed conditioned upon Lessee's: (i) acquiring all applicable governmental permits, (ii) furnishing Lessor with copies of both the permits and the plans and specifications prior to commencement of the work, and (iii) compliance with all conditions of said permits and other Applicable Requirements in a prompt and expeditious manner. Any Alterations or Utility Installations shall be performed in a workmanlike manner with good and sufficient materials. Lessee shall promptly upon completion furnish Lessor with as-built plans and specifications. For work which costs an amount in excess of one month's Base Rent, Lessor may condition its consent upon Lessee providing a lien and completion bond in an amount equal to 100% of the estimated cost of such Alteration or Utility Installation and/or upon Lessee's posting an additional Security Deposit with Lessor. *[Signature]*

(c) **Liens; Bonds.** Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises, and interest therein. Lessee shall give Lessor not less than 10 days notice prior to the commencement of any work in, on or about the Premises, and Lessor shall have the right to post notices of non-responsibility. If Lessee shall contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof. If Lessor shall require, Lessee shall furnish a surety bond in an amount equal to 150% of the amount of such contested lien, claim or demand, indemnifying Lessor against liability for the same. If Lessor elects to participate in any such action, Lessee shall pay Lessor's reasonable attorneys' fees and costs. *[Signature]*

7.4 Ownership; Removal; Surrender; and Restoration.

(a) **Ownership.** Subject to Lessor's right to require removal or elect ownership as hereinafter provided, all Alterations and Utility Installations made by Lessee shall be the property of Lessee, but considered a part of the Premises. Lessor may, at any time, elect in writing to be the owner of all or any specified part of the Lessee Owned Alterations and Utility Installations. Unless otherwise instructed per paragraph 7.4(b) hereof, all Lessee Owned Alterations and Utility Installations shall, at the expiration or termination of this Lease, become the property of Lessor and be surrendered by Lessee with the Premises.

(b) **Removal.** By delivery to Lessee of written notice from Lessor not earlier than 90 and not later than 30 days prior to the end of the term of this Lease, Lessor may require that any or all Lessee Owned Alterations or Utility Installations be removed by the expiration or termination of this Lease. Lessor may require the removal at any time of all or any part of any Lessee Owned Alterations or Utility Installations made without the required consent.

(c) **Surrender; Restoration.** Lessee shall surrender the Premises by the Expiration Date or any earlier termination date, with all of the improvements, parts and surfaces thereof broom clean and free of debris, and in good operating order, condition and state of repair, ordinary wear and tear excepted. "Ordinary wear and tear" shall not include any damage or deterioration that would have been prevented by good maintenance practice. Notwithstanding the foregoing, if this Lease is for 12 months or less, then Lessee shall surrender the Premises in the same condition as delivered to Lessee on the Start Date with NO allowance for ordinary wear and tear. Lessee shall repair any damage occasioned by the installation, maintenance or removal of Trade Fixtures, Lessee owned Alterations and/or Utility Installations, furnishings, and equipment as well as the removal of any storage tank installed by or for Lessee. Lessee shall completely remove from the Premises any and all Hazardous Substances brought onto the Premises by or for Lessee, or any third party (except Hazardous Substances which were deposited via underground migration from areas outside of the Premises, or if applicable, the Premises) even if such removal would require Lessee to perform or pay for work that exceeds statutory requirements. Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee. Any personal property of Lessee not removed on or before the Expiration Date or any earlier termination date shall be deemed to have been abandoned by Lessee and may be disposed of or retained by Lessor as Lessor may desire. The failure by Lessee to timely vacate the Premises pursuant to this Paragraph 7.4(c) without the express written consent of Lessor shall constitute a holdover under the provisions of Paragraph 26 below.

8. Insurance; Indemnity.

8.1 **Payment For Insurance.** Lessee shall pay for all insurance required under Paragraph 8 except to the extent of the cost attributable to liability insurance carried by Lessor under Paragraph 8.2(b) in excess of \$2,000,000 per occurrence. Premiums for policy periods commencing prior to or extending beyond the Lease term shall be prorated to correspond to the Lease term. Payment shall be made by Lessee to Lessor within 10 days following receipt of an invoice.

8.2 Liability Insurance.

(a) **Carried by Lessee.** Lessee shall obtain and keep in force a Commercial General Liability policy of insurance protecting Lessee and Lessor as an additional insured against claims for bodily injury, personal injury and property damage based upon or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than \$1,000,000 per occurrence with an annual aggregate of not less than \$2,000,000. Lessee shall add Lessor as an additional insured by means of an endorsement at least as broad as the Insurance Service Organization's "Additional Insured-Managers or Lessors of Premises" Endorsement. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an "insured contract" for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. Lessee shall provide an endorsement on its liability policy(ies) which provides that its insurance shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only. *[Signature]*

(b) **Carried by Lessor.** Lessor shall maintain liability insurance as described in Paragraph 8.2(a), in addition to, and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

8.3 Property Insurance - Building, Improvements and Rental Value.

(a) **Building and Improvements.** The Insuring Party shall obtain and keep in force a policy or policies in the name of Lessor, with loss payable to Lessor, any ground-lessor, and to any Lender insuring loss or damage to the Premises. The amount of such insurance shall be equal to the full insurable replacement cost of the Premises, as the same shall exist from time to time, or the amount required by any Lender, but in no event more than the commercially reasonable and available insurable value thereof. If Lessor is the Insuring Party, however, Lessee Owned Alterations and Utility Installations, Trade Fixtures, and Lessee's personal property shall be insured by Lessee under Paragraph 8.4 rather than by Lessor. If the

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coverage is available and commercially appropriate, such policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for debris removal and the enforcement of any Applicable Requirements requiring the upgrading, demolition, reconstruction or replacement of any portion of the Premises as the result of a covered loss. Said policy or policies shall also contain an agreed valuation provision in lieu of any coinsurance clause, waiver of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located. If such insurance coverage has a deductible clause, the deductible amount shall not exceed \$1,000 per occurrence, and Lessee shall be liable for such deductible amount in the event of an Insured Loss.

(b) **Rental Value.** The Insuring Party shall obtain and keep in force a policy or policies in the name of Lessor with loss payable to Lessor and any Lender, insuring the loss of the full Rent for one year with an extended period of indemnity for an additional 180 days ("Rental Value Insurance"). Said insurance shall contain an agreed valuation provision in lieu of any coinsurance clause, and the amount of coverage shall be adjusted annually to reflect the projected Rent otherwise payable by Lessee, for the next 12 month period. Lessee shall be liable for any deductible amount in the event of such loss.

(c) **Adjacent Premises.** If the Premises are part of a larger building, or of a group of buildings owned by Lessor which are adjacent to the Premises, the Lessee shall pay for any increase in the premiums for the property insurance of such building or buildings if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

3.4 Lessee's Property; Business Interruption Insurance.

(a) **Property Damage.** Lessee shall obtain and maintain insurance coverage on all of Lessee's personal property, Trade Fixtures, and Lessee Owned Alterations and Utility Installations. Such insurance shall be full replacement cost coverage with a deductible of not to exceed \$1,000 per occurrence. ~~The proceeds from any such insurance shall be used by Lessee for the replacement of personal property, Trade Fixtures and Lessee Owned Alterations and Utility Installations.~~ Lessee shall provide Lessor with written evidence that such insurance is in force.

(b) **Business Interruption.** Lessee shall obtain and maintain loss of income and extra expense insurance in amounts as will reimburse Lessee for direct or indirect loss of earnings attributable to all perils commonly insured against by prudent lessees in the business of Lessee or attributable to prevention of access to the Premises as a result of such perils.

(c) **No Representation of Adequate Coverage.** Lessor makes no representation that the limits or forms of coverage of insurance specified herein are adequate to cover Lessee's property, business operations or obligations under this Lease.

8.5 **Insurance Policies.** Insurance required herein shall be by companies duly licensed or admitted to transact business in the state where the Premises are located, and maintaining during the policy term a "General Policyholders Rating" of at least A-, VI, as set forth in the most current issue of "Best's Insurance Guide", or such other rating as may be required by a Lender. Lessee shall not do or permit to be done anything which invalidates the required insurance policies. Lessee shall, prior to the Start Date, deliver to Lessor certified copies of policies of such insurance or certificates evidencing the existence and amounts of the required insurance. No such policy shall be cancelable or subject to modification except after 30 days prior written notice to Lessor. Lessee shall, at least 10 days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand. Such policies shall be for a term of at least one year, or the length of the remaining term of this Lease, whichever is less. If either Party shall fail to procure and maintain the insurance required to be carried by it, the other Party may, but shall not be required to, procure and maintain the same.

8.6 **Waiver of Subrogation.** Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages against the other, for loss of or damage to its property arising out of or incident to the perils required to be insured against herein. The effect of such releases and waivers is not limited by the amount of insurance carried or required, or by any deductibles applicable hereto. The Parties agree to have their respective property damage insurance carriers waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 **Indemnity.** Except for Lessor's gross negligence or willful misconduct, Lessee shall indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, liens, judgments, penalties, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or in connection with, the use and/or occupancy of the Premises by Lessee. If any action or proceeding is brought against Lessor by reason of any of the foregoing matters, Lessee shall upon notice defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be defended or indemnified.

8.8 **Exemption of Lessor and its Agents from Liability.** Notwithstanding the negligence or breach of this Lease by Lessor or its agents, neither Lessor nor its agents shall be liable under any circumstances for: (i) injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessor's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, indoor air quality, ~~the presence of mold~~ or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, HVAC or lighting fixtures, or from any other cause, whether the said injury or damage results from conditions arising upon the Premises or upon other portions of the building of which the Premises are a part, or from other sources or places, (ii) any damages arising from any act or neglect of any other tenant of Lessor or from the failure of Lessor or its agents to enforce the provisions of any other lease in the Project, or (iii) injury to Lessee's business or for any loss of income or profit therefrom. Instead, it is intended that Lessee's sole recourse in the event of such damages or injury be to file a claim on the insurance policy(ies) that Lessee is required to maintain pursuant to the provisions of paragraph 8.

8.9 **Failure to Provide Insurance.** Lessee acknowledges that any failure on its part to obtain or maintain the insurance required herein will expose Lessor to risks and potentially cause Lessor to incur costs not contemplated by this Lease, the extent of which will be extremely difficult to ascertain. Accordingly, for any month or portion thereof that Lessee does not maintain the required insurance and/or does not provide Lessor with the required binders or certificates evidencing the existence of the required insurance, the Base Rent shall be automatically increased, without any requirement for notice to Lessee, by an amount equal to 10% of the then existing Base Rent or \$100, whichever is greater. The parties agree that such increase in Base Rent represents fair and reasonable compensation for the additional risk/costs that Lessor will incur by reason of Lessee's failure to maintain the required insurance. Such increase in Base Rent shall in no event constitute a waiver of Lessor's Default or Breach with respect to the failure to maintain such insurance, prevent the exercise of any of the other rights and remedies granted hereunder, nor relieve Lessee of its obligation to maintain the insurance specified in this Lease.

9. Damage or Destruction.

9.1 Definitions.

(a) "Premises Partial Damage" shall mean damage or destruction to the Improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, which can reasonably be repaired in 6 months or less from the date of the damage or destruction. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total. Notwithstanding the foregoing, Premises Partial Damage shall not include damage to windows, doors, and/or other similar items which Lessee has the responsibility to repair or replace pursuant to the provisions of Paragraph 7.1., except as provided in Section 7.1 (d)

(b) "Premises Total Destruction" shall mean damage or destruction to the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which cannot reasonably be repaired in 6 months or less from the date of the damage or destruction. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(c) "Insured Loss" shall mean damage or destruction to Improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a), irrespective of any deductible amounts or coverage limits involved.

(d) "Replacement Cost" shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of Applicable Requirements, and without deduction for depreciation.

(e) "Hazardous Substance Condition" shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance as defined in Paragraph 6.2(a), in, on, or under the Premises which requires repair, remediation, or restoration.

9.2 Partial Damage - Insured Loss. If a Premises Partial Damage that is an Insured Loss occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect; provided, however, that Lessee shall, at Lessor's election, make the repair of any damage or destruction the total cost to repair of which is \$10,000 or less, and, in such event, Lessor shall make any applicable insurance proceeds available to Lessee on a reasonable basis for that purpose. Notwithstanding the foregoing, if the required insurance was not in force or the insurance proceeds are not sufficient to effect such repair, the Insuring Party shall promptly contribute the shortage in proceeds (except as to the deductible which is Lessee's responsibility) as and when required to complete said repairs. In the event, however, such shortage was due to the fact that, by reason of the unique nature of the improvements, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within 10 days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said 10 day period, the party responsible for making the repairs shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If such funds or assurance are not received, Lessor may nevertheless elect by written notice to Lessee within 10 days thereafter to: (i) make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect, or (ii) have this Lease terminate 30 days thereafter. Lessee shall not be entitled to reimbursement of any funds contributed by Lessee to repair any such damage or destruction. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party. (See attachment)

9.3 Partial Damage - Uninsured Loss. If a Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense), Lessor may either: (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) terminate this Lease by giving written notice to Lessee within 30 days after receipt by Lessor of knowledge of the occurrence of such damage. Such termination shall be effective 60 days following the date of such notice. In the event Lessor elects to terminate this Lease, Lessee shall have the right within 10 days after receipt of the termination notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage without reimbursement from Lessor. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days after making such commitment. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not make the required commitment, this Lease shall terminate as of the date specified in the termination notice.

9.4 Total Destruction. Notwithstanding any other provision hereof, if a Premises Total Destruction occurs, this Lease shall terminate 60 days following such Destruction. If the damage or destruction was caused by the gross negligence or willful misconduct of Lessee, Lessor shall have the right to recover Lessor's damages from Lessee, except as provided in Paragraph 8.6. (See attachment)

9.5 Damage Near End of Term. If at any time during the last 6 months of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, Lessor may terminate this Lease effective 60 days following the date of occurrence of such damage by giving a written termination notice to Lessee within 30 days after the date of occurrence of such damage. Notwithstanding the foregoing, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by, (a) exercising such option and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs on or before the earlier of (i) the date which is 10 days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lessor shall, at Lessor's commercially reasonable expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate on the date specified in the termination notice and Lessee's option shall be extinguished.

9.6 Abatement of Rent; Lessee's Remedies.

(a) Abatement. In the event of Premises Partial Damage or Premises Total Destruction or a Hazardous Substance Condition for which Lessee is not responsible under this Lease, the Rent payable by Lessee for the period required for the repair, remediation or restoration of such damage shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired, but not to exceed the proceeds received from the Rental Value Insurance. All other obligations of Lessee hereunder shall be performed by Lessee, and Lessor shall have no liability for any such

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damage, destruction, remediation, repair or restoration except as provided herein.

(b) Remedies. If Lessor is obligated to repair or restore the Premises and does not commence, in a substantial and meaningful way, such repair or restoration within 90 (90) days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice, of Lessee's election to terminate this Lease on a date not less than 60 days following the giving of such notice. If Lessee gives such notice and such repair or restoration is not commenced within 30 days thereafter, this Lease shall terminate as of the date specified in said notice. If the repair or restoration is commenced within such 30 days, this Lease shall continue in full force and effect. "Commence" shall mean either the unconditional authorization of the preparation of the required plans, or the beginning of the actual work on the Premises, whichever first occurs.

9.7 Termination; Advance Payments. Upon termination of this Lease pursuant to Paragraph 6.2(g) or Paragraph 9, an equitable adjustment shall be made concerning advance Base Rent and any other advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's Security Deposit as has not been, or any remaining portion of Lessee's Security Deposit as is not then to be, used by Lessor.

10. Real Property Taxes.

10.1 Definition. As used herein, the term "Real Property Taxes" shall include any form of assessment; real estate, general, special, ordinary or extraordinary, or rental levy or tax (other than inheritance, personal income or estate taxes); improvement bond; and/or license fee imposed upon or levied against any legal or equitable interest of Lessor in the Premises or the Project, Lessor's right to other income therefrom, and/or Lessor's business of leasing, by any authority having the direct or indirect power to tax and where the funds are generated with reference to the Building address and where the proceeds so generated are to be applied by the city, county or other local taxing authority of a jurisdiction within which the Premises are located. Real Property Taxes shall also include any tax, fee, levy, assessment or charge, or any increase therein: (i) imposed by reason of events occurring during the term of this Lease, including but not limited to, a change in the ownership of the Premises, and (ii) levied on machinery or equipment provided by Lessor to Lessee pursuant to this Lease.

10.2 Payment of Taxes. In addition to Base Rent, Lessee shall pay to Lessor an amount equal to the Real Property Tax installment due at least 20 days prior to the applicable delinquency date. If any such installment shall cover any period of time prior to or after the expiration or termination of this Lease, Lessee's share of such installment shall be prorated. In the event Lessee incurs a late charge on any Rent payment, Lessor may estimate the current Real Property Taxes, and require that such taxes be paid in advance to Lessor by Lessee monthly in advance with the payment of the Base Rent. Such monthly payments shall be an amount equal to the amount of the estimated installment of taxes divided by the number of months remaining before the month in which said installment becomes delinquent. When the actual amount of the applicable tax bill is known, the amount of such equal monthly advance payments shall be adjusted as required to provide the funds needed to pay the applicable taxes. If the amount collected by Lessor is insufficient to pay such Real Property Taxes when due, Lessee shall pay Lessor, upon demand, such additional sum as is necessary. Advance payments may be intermingled with other moneys of Lessor and shall not bear interest. In the event of a Breach by Lessee in the performance of its obligations under this Lease, then any such advance payments may be treated by Lessor as an additional Security Deposit.

10.3 Joint Assessment. If the Premises are not separately assessed, Lessee's liability shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be conclusively determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available.

10.4 Personal Property Taxes. Lessee shall pay, prior to delinquency, all taxes assessed against and levied upon Lessee Owned Alterations, Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee. When possible, Lessee shall cause its Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. Utilities and Services. Lessee shall pay for all water, gas, heat, light, power, telephone, trash disposal and other utilities and services supplied to the Premises, together with any taxes thereon. If any such services are not separately metered or billed to Lessee, Lessee shall pay a reasonable proportion, to be determined by Lessor, of all charges jointly metered or billed. There shall be no abatement of rent and Lessor shall not be liable in any respect whatsoever for the inadequacy, stoppage, interruption or discontinuance of any utility or service due to riot, strike, labor dispute, breakdown, accident, repair or other cause beyond Lessor's reasonable control or in cooperation with governmental request or directions.

12. Assignment and Subletting.

12.1 Lessor's Consent Required.

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or encumber (collectively, "assign or assignment") or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent.

(b) Unless Lessee is a corporation and its stock is publicly traded on a national stock exchange, a change in the control of Lessee shall constitute an assignment requiring consent. The transfer, on a cumulative basis, of 25% or more of the voting control of Lessee shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition, financing, transfer, leveraged buy-out or otherwise), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee by an amount greater than 25% of such Net Worth as it was represented at the time of the execution of this Lease or at the time of the most recent assignment to which Lessor has consented, or as it exists immediately prior to said transaction or transactions constituting such reduction, whichever was or is greater, shall be considered an assignment of this Lease to which Lessor may withhold its consent. "Net Worth of Lessee" shall mean the net worth of Lessee (excluding any guarantors) established under generally accepted accounting principles.

(d) An assignment or subletting without consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1(c), or a noncurable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unapproved assignment or subletting as a noncurable Breach, Lessor may either: (i) terminate this Lease, or (ii) upon 30 days written notice, increase the monthly Base Rent to 110% of the Base

Rent then in effect. Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to 110% of the price previously in effect, and (ii) all fixed and non-fixed rental adjustments scheduled during the remainder of the Lease term shall be increased to 110% of the scheduled adjusted rent.

(e) Lessee's remedy for any breach of Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

(f) Lessor may reasonably withhold consent to a proposed assignment or subletting if Lessee is in Default at the time consent is requested.

(g) Notwithstanding the foregoing, allowing a de minimis portion of the Premises, ie. 20 square feet or less, to be used by a third party vendor in connection with the installation of a vending machine or payphone shall not constitute a subletting.

12.2 Terms and Conditions Applicable to Assignment and Subletting.

(a) Regardless of Lessor's consent, no assignment or subletting shall: (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, or (iii) alter the primary liability of Lessee for the payment of Rent or for the performance of any other obligations to be performed by Lessee.

(b) Lessor may accept Rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of Rent or performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for Lessee's Default or Breach.

(c) Lessor's consent to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting.

(d) In the event of any Default or Breach by Lessee, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of Lessee's obligations under this Lease, including any assignee or sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefor to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises, if any, together with a fee of \$300 as consideration for Lessor's considering and processing said request. Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested. (See also Paragraph 30)

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment, entering into such sublease, or entering into possession of the Premises or any portion thereof, be deemed to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented to in writing.

(g) Lessor's consent to any assignment or subletting shall not transfer to the assignee or sublessee any Option granted to the original Lessee by this Lease unless such transfer is specifically consented to by Lessor in writing. (See Paragraph 39.2)

12.3 Additional Terms and Conditions Applicable to Subletting. The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all Rent payable on any sublease, and Lessor may collect such Rent and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach shall occur in the performance of Lessee's obligations, Lessee may collect said Rent. In the event that the amount collected by Lessor exceeds Lessee's then outstanding obligations any such excess shall be refunded to Lessee. Lessor shall not, by reason of the foregoing or any assignment of such sublease, nor by reason of the collection of Rent, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor all Rent due and to become due under the sublease. Sublessee shall rely upon any such notice from Lessor and shall pay all Rents to Lessor without any obligation or right to inquire as to whether such Breach exists, notwithstanding any claim from Lessee to the contrary.

(b) In the event of a Breach by Lessee, Lessor may, at its option, require sublessee to attorn to Lessor, in which event Lessor shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any prior Defaults or Breaches of such sublessor.

(c) Any matter requiring the consent of the sublessor under a sublease shall also require the consent of Lessor.

(d) No sublessee shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee.

13. Default; Breach; Remedies.

13.1 Default; Breach. A "Default" is defined as a failure by the Lessee to comply with or perform any of the terms, covenants, conditions or Rules and Regulations under this Lease. A "Breach" is defined as the occurrence of one or more of the following Defaults, and the failure of Lessee to cure such Default within any applicable grace period:

(a) The abandonment of the Premises; or the vacating of the Premises without providing a commercially reasonable level of security, or where the coverage of the property insurance described in Paragraph 8.3 is jeopardized as a result thereof, or without providing reasonable assurances to minimize potential vandalism.

(b) The failure of Lessee to make any payment of Rent or any Security Deposit required to be made by Lessee hereunder, whether to Lessor or to a third party, when due, to provide reasonable evidence of insurance or surety bond, or to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of 3 business days following written notice to Lessee. THE ACCEPTANCE BY LESSOR OF A PARTIAL PAYMENT OF RENT OR SECURITY DEPOSIT SHALL NOT CONSTITUTE A WAIVER OF ANY OF LESSOR'S RIGHTS, INCLUDING LESSOR'S RIGHT TO RECOVER POSSESSION OF THE PREMISES.

(c) The failure of Lessee to allow Lessor and/or its agents access to the Premises or the commission of waste, act or acts constituting public or private nuisance, and/or an illegal activity on the Premises by Lessee, where such actions continue for a period of 3 business days

following written notice to Lessee. ^{(i) (See Attachment)}

(d) The failure by Lessee to provide (i) reasonable written evidence of compliance with Applicable Requirements, (ii) the service contracts, (iii) the rescission of an unauthorized assignment or subletting, (iv) an Estoppel Certificate or financial statements, (v) a requested subordination, (vi) evidence concerning any guaranty and/or Guarantor, (vii) any document requested under Paragraph 42, (viii) material safety data sheets (MSDS), or (ix) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this Lease, where any such failure continues for a period of 10 days following written notice to Lessee.

(e) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 40 hereof, other than those described in subparagraphs 13.1(a), (b), (c) or (d), above, where such Default continues for a period of 30 days after written notice; provided, however, that if the nature of Lessee's Default is such that more than 30 days are reasonably required for its cure, then it shall not be deemed to be a Breach if Lessee commences such cure within said 30 day period and thereafter diligently prosecutes such cure to completion.

(f) The occurrence of any of the following events: (i) the making of any general arrangement or assignment for the benefit of creditors; (ii) becoming a "debtor" as defined in 11 U.S.C. §101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessor's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within 30 days; provided, however, in the event that any provision of this subparagraph is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

(g) The discovery that any financial statement of Lessee or of any Guarantor given to Lessor was materially false.

(h) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a Guarantor, (ii) the termination of a Guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a Guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a Guarantor's refusal to honor the guaranty, or (v) a Guarantor's breach of its guaranty obligation on an anticipatory basis, and Lessee's failure, within 60 days following written notice of any such event, to provide written alternative assurance or security, which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the Guarantors that existed at the time of execution of this Lease.

13.2 Remedies. If Lessee fails to perform any of its affirmative duties or obligations, within 10 days after written notice (or in case of an emergency, without notice), Lessor may, at its option, perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. Lessee shall pay to Lessor an amount equal to 115% of the costs and expenses incurred by Lessor in such performance upon receipt of an invoice therefor. In the event of a Breach, Lessor may, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Lessee shall immediately surrender possession to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the unpaid Rent which had not been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessor's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (ii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of the District within which the Premises are located at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Breach of this Lease shall not waive Lessor's right to recover damages under Paragraph 12. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding any unpaid Rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit. If a notice and grace period required under Paragraph 13.1 was not previously given, a notice to pay rent or quit, or to perform or quit given to Lessee under the unlawful detainer statute shall also constitute the notice required by Paragraph 13.1. In such case, the applicable grace period required by Paragraph 13.1 and the unlawful detainer statute shall run concurrently, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession and recover the Rent as it becomes due, in which event Lessee may sublet or assign, subject only to reasonable limitations. Acts of maintenance, efforts to relet, and/or the appointment of a receiver to protect the Lessor's interests, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available under the laws or judicial decisions of the state wherein the Premises are located. The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3 Inducement Recapture. Any agreement for free or abated rent or other charges, or for the giving or paying by Lessor to or for Lessee of any cash or other bonus, inducement or consideration for Lessee's entering into this Lease, all of which concessions are hereinafter referred to as "Inducement Provisions," shall be deemed conditioned upon Lessee's full and faithful performance of all of the terms, covenants and conditions of this Lease. Upon Breach of this Lease by Lessee, any such Inducement Provision shall automatically be deemed deleted from this Lease and of no further force or effect, and any rent, other charge, bonus, inducement or consideration theretofore abated, given or paid by Lessor under such an inducement Provision shall be immediately due and payable by Lessee to Lessor, notwithstanding any subsequent cure of said Breach by Lessee. The acceptance by Lessor of rent or the cure of the Breach which initiated the operation of this paragraph shall not be deemed a waiver by Lessor of the provisions of this paragraph unless specifically so stated in writing by Lessor at the time of such acceptance.

13.4 Late Charges. Lessee hereby acknowledges that late payment by Lessee of Rent will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by any Lender. Accordingly, if any Rent shall not be received by Lessor

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within 5 days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall immediately pay to Lessor a one-time late charge equal to 10% of each such overdue amount or \$100, whichever is greater. The Parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of such late payment. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent the exercise of any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for 3 consecutive installments of Base Rent, then notwithstanding any provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance.

13.5 **Interest.** Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor, when due as to scheduled payments (such as Base Rent) or within 30 days following the date on which it was due for non-scheduled payment, shall bear interest from the date when due, as to scheduled payments, or the 31st day after it was due as to non-scheduled payments. The interest ("interest") charged shall be computed at the rate of 10% per annum but shall not exceed the maximum rate allowed by law. Interest is payable in addition to the potential late charge provided for in Paragraph 13.4.

13.6 **Breach by Lessor.**

(a) **Notice of Breach.** Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph, a reasonable time shall in no event be less than 30 days after receipt by Lessor, and any Lender whose name and address shall have been furnished Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed, provided, however, that if the nature of Lessor's obligation is such that more than 30 days are reasonably required for its performance, then Lessor shall not be in breach if performance is commenced within such 30 day period and thereafter diligently pursued to completion.

(b) **Performance by Lessee on Behalf of Lessor.** In the event that neither Lessor nor Lender cures said breach within 30 days after receipt of said notice, or if having commenced said cure they do not diligently pursue it to completion, then Lessee may elect to cure said breach at Lessee's expense and offset from Rent the actual and reasonable cost to perform such cure, provided, however, that such offset shall not exceed an amount equal to the greater of one month's Base Rent or the Security Deposit, reserving Lessee's right to seek reimbursement from Lessor for any such expense in excess of such offset. Lessee shall document the cost of said cure and supply said documentation to Lessor.

14. **Condemnation.** If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (collectively "Condemnation"), this Lease shall terminate as to the part taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the Building, or more than 25% of that portion of the Premises not occupied by any building, is taken by Condemnation, Lessee may, at Lessee's option, to be exercised in writing within 10 days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within 10 days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in proportion to the reduction in utility of the Premises caused by such Condemnation. Condemnation awards and/or payments shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold, the value of the part taken, or for severance damages; provided, however, that Lessee shall be entitled to any compensation paid by the condemnor for Lessee's relocation expenses, loss of business goodwill and/or Trade Fixtures, without regard to whether or not this Lease is terminated pursuant to the provisions of this Paragraph. All Alterations and Utility Installations made to the Premises by Lessee, for purposes of Condemnation only, shall be considered the property of the Lessee and Lessee shall be entitled to any and all compensation which is payable therefor. In the event that this Lease is not terminated by reason of the Condemnation, Lessor shall repair any damage to the Premises caused by such Condemnation.

15. **Brokerage Fees.**

~~15.1—Additional Commission.—In addition to the payments owed pursuant to Paragraph 1.0 above, and unless Lessor and the Brokers otherwise agree in writing, Lessor agrees that: (a) if Lessee exercises any Option, (b) if Lessee or anyone affiliated with Lessee acquires any rights to the Premises or other premises owned by Lessor and located within the same Project, if any, within which the Premises is located, (c) if Lessee remains in possession of the Premises, with the consent of Lessor, after the expiration of the Lease, or (d) if Base Rent is increased, whether by agreement or operation of an escalation clause herein, then, Lessor shall pay Brokers a fee in accordance with the schedule of the Brokers in effect at the time of the execution of this Lease.~~

~~15.2—Assumption of Obligations.—Any buyer or transferee of Lessor's interest in this Lease shall be deemed to have assumed Lessor's obligation hereunder. Brokers shall be third party beneficiaries of the provisions of Paragraphs 1.0, 15.1, 22 and 31. If Lessor fails to pay to Brokers any amounts due as and for brokerage fees pertaining to this Lease when due, then such amounts shall accrue interest. In addition, if Lessor fails to pay any amounts to Lessee's Broker when due, Lessee's Broker may send written notice to Lessor and Lessee of such failure and if Lessor fails to pay such amounts within 10 days after said notice, Lessee shall pay said monies to its Broker and offset such amounts against Rent. In addition, Lessee's Broker shall be deemed to be a third party beneficiary of any commission agreement entered into by and/or between Lessor and Lessor's Broker for the limited purpose of collecting any brokerage fee owed.~~

15.3 **Representations and Indemnities of Broker Relationships.** Lessee and Lessor each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any) in connection with this Lease, and that no one other than said named Brokers is entitled to any commission or finder's fee in connection herewith. Lessee and Lessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorneys' fees reasonably incurred with respect thereto.

16. **Estoppel Certificates.**

(a) Each Party (as "Responding Party") shall within 10 days after written notice from the other Party (the "Requesting Party") execute, acknowledge and deliver to the Requesting Party a statement in writing in form similar to the then most current "Estoppel Certificate" form published by the AIR Commercial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably

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requested by the Requesting Party.

(b) If the Responding Party shall fail to execute or deliver the Estoppel Certificate within such 10 day period, the Requesting Party may execute an Estoppel Certificate stating that: (i) the Lease is in full force and effect without modification except as may be represented by the Requesting Party, (ii) there are no uncured defaults in the Requesting Party's performance, and (iii) if Lessor is the Requesting Party, not more than one month's rent has been paid in advance. Prospective purchasers and encumbrancers may rely upon the Requesting Party's Estoppel Certificate, and the Responding Party shall be estopped from denying the truth of the facts contained in said Certificate.

(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof, Lessee and all Guarantors shall within 10 days after written notice from Lessor deliver to any potential lender or purchaser designated by Lessor such financial statements as may be reasonably required by such lender or purchaser, including but not limited to Lessee's financial statements for the past 3 years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. **Definition of Lessor.** The term "Lessor" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises, or, if this is a sublease, of the Lessee's interest in the prior lease. In the event of a transfer of Lessor's title or interest in the Premises or this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor. Upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined.

18. **Severability.** The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. **Days.** Unless otherwise specifically indicated to the contrary, the word "days" as used in this Lease shall mean and refer to calendar days.

20. **Limitation on Liability.** The obligations of Lessor under this Lease shall not constitute personal obligations of Lessor or its partners, members, directors, officers or shareholders, and Lessee shall look to the Premises, and to no other assets of Lessor, for the satisfaction of any liability of Lessor with respect to this Lease, and shall not seek recourse against Lessor's partners, members, directors, officers or shareholders, or any of their personal assets for such satisfaction.

21. **Time of Essence.** Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

22. **No Prior or Other Agreements; Broker Disclaimer.** This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Lease and as to the use, nature, quality and character of the Premises. Brokers have no responsibility with respect thereto or with respect to any default or breach hereof by either Party.

23. **Notices.**

23.1 **Notice Requirements.** All notices required or permitted by this Lease or applicable law shall be in writing and may be delivered in person (by hand or by courier) or may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notices. Either Party may by written notice to the other specify a different address for notice, except that upon Lessor's taking possession of the Premises, the Premises shall constitute Lessee's address for notice. A copy of all notices to Lessor shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate in writing.

23.2 **Date of Notice.** Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail the notice shall be deemed given 72 hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantee next day delivery shall be deemed given 24 hours after delivery of the same to the Postal Service or courier. Notices transmitted by facsimile transmission or similar means shall be deemed delivered upon telephone confirmation of receipt (confirmation report from fax machine is sufficient), provided a copy is also delivered via delivery or mail. If notice is received on a Saturday, Sunday or legal holiday, it shall be deemed received on the next business day.

24. **Waivers.**

(a) No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or of any other term, covenant or condition hereof. Lessor's consent to, or approval of, any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent.

(b) The acceptance of Rent by Lessor shall not be a waiver of any Default or Breach by Lessee. Any payment by Lessee may be accepted by Lessor on account of moneys or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

(c) THE PARTIES AGREE THAT THE TERMS OF THIS LEASE SHALL GOVERN WITH REGARD TO ALL MATTERS RELATED THERETO AND HEREBY WAIVE THE PROVISIONS OF ANY PRESENT OR FUTURE STATUTE TO THE EXTENT THAT SUCH

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STATUTE IS INCONSISTENT WITH THIS LEASE.

25. **Disclosures Regarding The Nature of a Real Estate Agency Relationship.**

(a) When entering into a discussion with a real estate agent regarding a real estate transaction, a Lessor or Lessee should from the outset understand what type of agency relationship or representation it has with the agent or agents in the transaction. Lessor and Lessee acknowledge being advised by the Brokers in this transaction, as follows:

(i) **Lessor's Agent.** A Lessor's agent under a listing agreement with the Lessor acts as the agent for the Lessor only. A Lessor's agent or subagent has the following affirmative obligations: To the Lessor. A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessor. To the Lessee and the Lessor. a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(ii) **Lessor's Agent.** An agent can agree to act as agent for the Lessee only. In these situations, the agent is not the Lessor's agent, even if by agreement the agent may receive compensation for services rendered, either in full or in part from the Lessor. An agent acting only for a Lessee has the following affirmative obligations. To the Lessee. A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessee. To the Lessee and the Lessor. a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(iii) **Agent Representing Both Lessor and Lessee.** A real estate agent, either acting directly or through one or more associate licensees, can legally be the agent of both the Lessor and the Lessee in a transaction, but only with the knowledge and consent of both the Lessor and the Lessee. In a dual agency situation, the agent has the following affirmative obligations to both the Lessor and the Lessee: a. A fiduciary duty of utmost care, integrity, honesty and loyalty in the dealings with either Lessor or the Lessee. b. Other duties to the Lessor and the Lessee as stated above in subparagraphs (i) or (ii). In representing both Lessor and Lessee, the agent may not without the express permission of the respective Party, disclose to the other Party that the Lessor will accept rent in an amount less than that indicated in the listing or that the Lessee is willing to pay a higher rent than that offered. The above duties of the agent in a real estate transaction do not relieve a Lessor or Lessee from the responsibility to protect their own interests. Lessor and Lessee should carefully read all agreements to assure that they adequately express their understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional.

(b) Brokers have no responsibility with respect to any default or breach hereof by either Party. The Parties agree that no lawsuit or other legal proceeding involving any breach of duty, error or omission relating to this Lease may be brought against Broker more than one year after the Start Date and that the liability (including court costs and attorneys' fees), of any Broker with respect to any such lawsuit and/or legal proceeding shall not exceed the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Broker's liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

(c) Lessor and Lessee agree to identify to Brokers as "Confidential" any communication or information given Brokers that is considered by such Party to be confidential.

26. **No Right To Holdover.** Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or termination of this Lease. In the event that Lessee holds over, then the Base Rent shall be increased to 160% / 125% of the Base Rent applicable immediately preceding the expiration or termination. Nothing contained herein shall be construed as consent by Lessor to any holding over by Lessee.

27. **Cumulative Remedies.** No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. **Covenants and Conditions; Construction of Agreement.** All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions. In construing this Lease, all headings and titles are for the convenience of the Parties only and shall not be considered a part of this Lease. Whenever required by the context, the singular shall include the plural and vice versa. This Lease shall not be construed as if prepared by one of the Parties, but rather according to its fair meaning as a whole, as if both Parties had prepared it.

29. **Binding Effect; Choice of Law.** This Lease shall be binding upon the Parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. **Subordination; Attornment; Non-Disturbance.**

30.1 **Subordination.** This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "Security Device"), now or hereafter placed upon the Premises, to any and all advances made on the security thereof, and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as "Lender") shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recording thereof.

30.2 **Attornment.** In the event that Lessor transfers title to the Premises, or the Premises are acquired by another upon the foreclosure or termination of a Security Device to which this Lease is subordinated (i) Lessee shall, subject to the non-disturbance provisions of Paragraph 30.3, attorn to such new owner, and upon request, enter into a new lease, containing all of the terms and provisions of this Lease, with such new owner for the remainder of the term hereof, or, at the election of the new owner, this Lease will automatically become a new lease between Lessee and such new owner, and (ii) Lessor shall thereafter be relieved of any further obligations hereunder and such new owner shall assume all of Lessor's obligations, except that such new owner shall not: (a) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of

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ownership; (b) be subject to any offsets or defenses which Lessee might have against any prior lessor, (c) be bound by prepayment of more than one month's rent, or (d) be liable for the return of any security deposit paid to any prior lessor which was not paid or credited to such new owner.

30.3 **Non-Disturbance.** With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a "Non-Disturbance Agreement") from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises. Further, within 60 days after the execution of this Lease, Lessor shall, if requested by Lessee, use its commercially reasonable efforts to obtain a Non-Disturbance Agreement from the holder of any pre-existing Security Device which is secured by the Premises. In the event that Lessor is unable to provide the Non-Disturbance Agreement within said 60 days, then Lessee may, at Lessee's option, directly contact Lender and attempt to negotiate for the execution and delivery of a Non-Disturbance Agreement.

30.4 **Self-Executing.** The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that, upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

31. **Attorneys' Fees.** If any Party or Broker brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "Prevailing Party" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Lessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach (\$200 is a reasonable minimum per occurrence for such services and consultation).

32. **Lessor's Access; Showing Premises; Repairs.** Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times after reasonable prior notice for the purpose of showing the same to prospective purchasers, lenders, or tenants, and making such alterations, repairs, improvements or additions to the Premises as Lessor may deem necessary or desirable and the erecting, using and maintaining of utilities, services, pipes and conduits through the Premises and/or other premises as long as there is no material adverse effect to Lessee's use of the Premises. All such activities shall be without abatement of rent or liability to Lessee. (See attached)

33. **Auctions.** Lessee shall not conduct, nor permit to be conducted, any auction upon the Premises without Lessor's prior written consent. Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to permit an auction.

34. **Signs.** Lessor may place on the Premises ordinary "For Sale" signs at any time and ordinary "For Lease" signs during the last 6 months of the term hereof. Except for ordinary "for sublease" signs, Lessee shall not place any sign upon the Premises without Lessor's prior written consent. All signs must comply with all Applicable Requirements.

35. **Termination; Merger.** Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, that Lessor may elect to continue any one or all existing subtenancies. Lessor's failure within 10 days following any such event to elect to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. **Consents.** Except as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent, including but not limited to consents to an assignment, a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee upon receipt of an invoice and supporting documentation therefor. Lessor's consent to any act, assignment or subletting shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent. The failure to specify herein any particular condition to Lessor's consent shall not preclude the imposition by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given. In the event that either Party disagrees with any determination made by the other hereunder and reasonably requests the reasons for such determination, the determining party shall furnish its reasons in writing and in reasonable detail within 10 business days following such request.

37. **Guarantor. (RESERVED)**
37.1 ~~Execution.~~ The Guarantors, if any, shall each execute a guaranty in the form most recently published by the AIR Commercial Real Estate Association, and each such Guarantor shall have the same obligations as Lessee under this Lease.

37.2 ~~Default.~~ It shall constitute a Default of the Lessee if any Guarantor fails to refuse, upon request to provide: (a) evidence of the execution of the guaranty, including the authority of the party signing on Guarantor's behalf to obligate Guarantor, and in the case of a corporate Guarantor, a certified copy of a resolution of its board of directors authorizing the making of such guaranty, (b) current financial statements, (c) an Estoppel Certificate, or (d) written confirmation that the guaranty is still in effect.

38. **Quiet Possession.** Subject to payment by Lessee of the Rent and performance of all of the covenants, conditions and provisions on

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Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession and quiet enjoyment of the Premises during the term hereof.

39. **Options.** If Lessee is granted an Option, as defined below, then the following provisions shall apply:

39.1 **Definition. "Option"** shall mean: (a) the right to extend or reduce the term of or renew this Lease or to extend or reduce the term of or renew any lease that Lessee has on other property of Lessor; (b) the right of first refusal or first offer to lease either the Premises or other property of Lessor; (c) the right to purchase, the right of first offer to purchase or the right of first refusal to purchase the Premises or other property of Lessor.

39.2 **Options Personal To Original Lessee.** Any Option granted to Lessee in this Lease is personal to the original Lessee, and cannot be assigned or exercised by anyone other than said original Lessee and only while the original Lessee is in full possession of the Premises and, if requested by Lessor, with Lessee certifying that Lessee has no intention of thereafter assigning or subletting.

39.3 **Multiple Options.** In the event that Lessee has any multiple Options to extend or renew this Lease, a later Option cannot be exercised unless the prior Options have been validly exercised.

39.4 **Effect of Default on Options.**

(a) Lessee shall have no right to exercise an Option: (i) during the period commencing with the giving of any notice of Default and continuing until said Default is cured, (ii) during the period of time any Rent is unpaid (without regard to whether notice thereof is given Lessee), (iii) during the time Lessee is in breach of this Lease, or (iv) in the event that Lessee has been given 3 or more notices of separate Default, whether or not the Defaults are cured, during the 12 month period immediately preceding the exercise of the Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) An Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and prior to the commencement of the extended term or completion of the purchase, (i) Lessee fails to pay Rent for a period of 30 days after such Rent becomes due (without any necessity of Lessor to give notice thereof), or (ii) if Lessee commits a Breach of this Lease.

40. **Multiple Buildings.** If the Premises are a part of a group of buildings controlled by Lessor, Lessee agrees that it will abide by and conform to all reasonable rules and regulations which Lessor may make from time to time for the management, safety, and care of said properties, including the care and cleanliness of the grounds and including the parking, loading and unloading of vehicles, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessee also agrees to pay its fair share of common expenses incurred in connection with such rules and regulations.

41. **Security Measures.** Lessee hereby acknowledges that the Rent payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties.

42. **Reservations.** Lessor reserves to itself the right, from time to time, to grant, without the consent or joinder of Lessee, such easements, rights and dedications that Lessor deems necessary, and to cause the recondition of parcel maps and restrictions, so long as such easements, rights, dedications, maps and restrictions do not unreasonably interfere with the use of the Premises by Lessee. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate any such easement rights, dedication, map or restrictions.

43. **Performance Under Protest.** If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay. A Party who does not institute suit for the recovery of sums paid "under protest" with 6 months shall be deemed to have waived its right to protest such payment.

44. **Authority; Multiple Parties; Execution.**

(a) If either Party hereto is a corporation, trust, limited liability company, partnership, or similar entity, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. Each Party shall, within 30 days after request, deliver to the other Party satisfactory evidence of such authority.

(b) If this Lease is executed by more than one person or entity as "Lessee", each such person or entity shall be jointly and severally liable hereunder. It is agreed that any one of the named Lessees shall be empowered to execute any amendment to this Lease, or other document ancillary thereto and bind all of the named Lessees, and Lessor may rely on the same as if all of the named Lessees had executed such document.

(c) This Lease may be executed by the Parties in counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

45. **Conflict.** ~~Any conflict between the printed provisions of this Lease and typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.~~ (See attachment)

46. **Offer.** Preparation of this Lease by either Party or their agent and submission of same to the other Party shall not be deemed an offer to lease to the other Party. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

47. **Amendments.** This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable non-monetary modifications to this Lease as may be reasonably required by a Lender in connection with the obtaining of normal financing or refinancing of the Premises.

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48. **Waiver of Jury Trial.** THE PARTIES HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING INVOLVING THE PROPERTY OR ARISING OUT OF THIS AGREEMENT.

49. **Mediation and Arbitration of Disputes.** An Addendum requiring the Mediation and/or the Arbitration of all disputes between the Parties and/or Brokers arising out of this Lease is is not attached to this Lease. *(See attachment)* 

50. **Americans with Disabilities Act.** Since compliance with the Americans with Disabilities Act (ADA) is dependent upon Lessee's specific use of the Premises, Lessor makes no warranty or representation as to whether or not the Premises comply with ADA or any similar legislation. In the event that Lessee's use of the Premises requires modifications or additions to the Premises in order to be in ADA compliance, Lessee agrees to make any such necessary modifications and/or additions at Lessee's expense.

LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AIR COMMERCIAL REAL ESTATE ASSOCIATION OR BY ANY BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

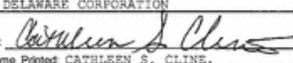
- SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE.
- RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING OF THE PREMISES, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, AND THE SUITABILITY OF THE PREMISES FOR LESSEE'S INTENDED USE.

WARNING: IF THE PREMISES IS LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE LEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PREMISES IS LOCATED.

The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures.

Executed at: _____ Executed at: _____
On: _____ On: _____

By LESSOR: HILLSIDE ASSOCIATES II, LLC By LESSEE: AEROVIRONMENT, INC.
A DELAWARE CORPORATION

By:  By: 
Name Printed: MARGIE M. WEST Name Printed: CATHLEEN S. CLINE,
Title: AUTHORIZED AGENT Title: VP ADMIN

By: _____ By: _____
Name Printed: _____ Name Printed: _____
Title: _____ Title: _____
Address: _____ Address: _____
Telephone: (____) _____ Telephone: (____) _____
Facsimile: (____) _____ Facsimile: (____) _____
Federal ID No. _____ Federal ID No. _____

BROKER: _____ BROKER: _____

Attr: _____ Attr: _____
Title: _____ Title: _____
Address: _____ Address: _____
Telephone: (____) _____ Telephone: (____) _____
Facsimile: (____) _____ Facsimile: (____) _____
Federal ID No. _____ Federal ID No. _____

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NOTICE: These forms are often modified to meet changing requirements of law and industry needs. Always write or call to make sure you are utilizing the most current form: AIR Commercial Real Estate Association, 800 W 6th Street, Suite 800, Los Angeles, CA 90017. Telephone No. (213) 687-8777. Fax No.: (213) 687-8616.

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FORM STN-10-6/07E



ADDENDUM

Date: DECEMBER 12, 2013

By and Between (Lessor) HILLSIDE ASSOCIATES II, LLC
(Lessee) AEROVIRONMENT, INC., A DELAWARE CORPORATION

Address of Premises: 996 FLOWER GLEN STREET
SIMI VALLEY, CA 93065

1. **Base Rent Partial Abatement.** Provided Lessee shall not be in material default of the Lease, after any applicable notice and cure periods, immediately prior to or during any Base Rent partial abatement period, as provided in that certain Rental Concession Agreement attached hereto, the Base Rent payable by Lessee to Lessor for the Premises shall be partially abated to the extent provided and during the periods provided in that certain Rental Concession Agreement attached hereto.
2. **Maintenance and Repairs.** Paragraph 7 of this Lease is hereby amended to provide that Lessee shall be obligated to manage and contract directly for services related to Lessee's obligations to maintain the Premises, including, but not limited to, all utilities and janitorial service. Lessor shall be responsible, at Lessor's sole cost and expense, for that portion of roof replacement and future roof repair cost which exceeds \$1,000 per occurrence, per building. Lessee shall be responsible, at Lessee's sole cost and expense, for the first \$1,000 of roof replacement and future roof repair cost not payable by Lessor above. A roof assessment of the Premises shall be performed by a licensed roofing contractor. All roofing replacement and/or repair work shall be performed to applicable governmental code requirements, within one hundred and twenty (120) days of lease execution weather permitting.
3. **Tax Protest.** During the term of Lease, Lessee shall be entitled, at its election, to file a protest with the Ventura County Tax Assessor's Office to reduce the real property taxes to reflect the current valuation of the Property.
4. **Exterior Windows and Doors.** Prior to January 31st, 2014, subject to such extension of additional time as may be required due to weather, Lessor, at Lessor's sole cost and expense, shall repair and re-seal all exterior windows and doors of the Premises, in a workman-like and professional manner, as may be required. Lessee shall maintain all exterior windows and doors of the Premises throughout Term of the Lease.
5. **HVAC.** Lessor and Lessee agree that, within a commercially reasonable time, upon mutual agreement of Lessor and Lessee, the HVAC units of the Premises that have exceeded their useful life and any other HVAC major components (such as compressors, fans, etc.) that fail, for reasons other than failure of Lessee to maintain such HVAC major components, during the extended Term of the Lease (collectively, the "HVAC Work") shall be repaired or replaced, as may be required, subject to the cost allocation provided below. Lessee shall not perform any of the HVAC Work without Lessor's prior approval of the work to be done and the estimated cost of such work. The cost of such HVAC Work shall be borne 50% by Lessor and 50% by Lessee and Lessee's share of such cost shall be payable by Lessee upon demand by Lessor. Lessee shall be entitled to apply its Base Rent partial abatement or any portion thereof during the twelfth (12th) through the sixteenth (16th) months of the Term of this Lease, as provided in the attached Rental Concession Agreement, to satisfy its obligation for its share of such HVAC Work and, in the event of such election by Lessee, the amount of such Base Rent partial abatement shall be reduced by the amount of Lessee's share of the HVAC Work so applied (Base rent is not increased and remains the same. Lessee is just not entitled to offset cost of HVAC work as rent concession since Lessee did not pay). Notwithstanding the foregoing, Lessee shall maintain all HVAC units and HVAC major components during the Term through a service contract with Lessor's approved HVAC vendor.
6. **Parking Area.** Lessor shall, within twelve (12) months of lease execution weather permitting (such work to be done during daylight savings time) slurry coat and restripe the parking areas of the Property, at Lessor's sole cost and expense, on non-work days (Saturdays and Sundays).
7. **Rental Refund Payment.** Promptly after mutual execution of this Amendment, Lessor agrees to refund to Lessee Base Rent paid by Lessee for the Premises during 2013 in the amount of \$107,520.
8. **Option to Extend Term.** Lessee shall have one (1) option to extend the Term for sixty (60) months on the terms and subject to the conditions provided in the attached Option to Renew.
9. **Street Privatization.** Lessor agrees to cooperate with the City of Simi Valley with respect to the privatization of Enchanted Way/Flower Glen Street. Lessee shall be responsible for obtaining all approvals and permits necessary for such privatization, at Lessee's sole cost and expense. If Enchanted Way/Flower Glen Street are successfully privatized, Lessee shall be responsible for all maintenance of such privatized street(s), at Lessee's sole cost and expense during the Lease term.
10. **Non-Disturbance Agreement.** Lessor and Lessee acknowledge their respective rights and obligations under Paragraph 30.3 regarding Non-Disturbance Agreements.

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AIR COMMERCIAL REAL ESTATE ASSOCIATION
STANDARD INDUSTRIAL/COMMERCIAL SINGLE-TENANT LEASE - NET

ATTACHMENT

7.1 (b)

However, if in Lessor's sole opinion one or more service providers contracted for by Lessee is performing in a substandard fashion, Lessor may give Lessee 30 days' written notice to cure the problem. Should Lessee fail to cure the substandard performance within that 30 day period, then Lessor may, at its option, procure and maintain a substitute service provider(s), the cost for which Lessee shall reimburse Lessor, upon demand.

9.2

..., except emergency repairs required in the judgment of Lessee to prevent additional loss to real or personal property of the parties hereto.

9.4

...7 days after Lessor determines that damage is Total Destruction.

13.1 (c)

No default or breach shall occur when access is denied by Lessee when Lessor or its employees or agents do not comply with the citizenship and status requirements of the International Traffic in Arms Regulations of the United States Government. Such regulations require that anyone allowed access to the building must be a U.S. citizen, legal permanent resident or a member of a protected class since items produced in the premises are listed on the U.S. Munitions list of the ITAR.

32.

No default or breach shall occur when access is denied by Lessee when Lessor or its employees or agents do not comply with the citizenship and status requirements of the International Traffic in Arms Regulations of the United States Government. Such regulations require that anyone allowed access to the building must be a U.S. citizen, legal permanent resident or a member of a protected class since items produced in the premises are listed on the U.S. Munitions list of the ITAR.

45.

Agreement constitutes the entire agreement between the parties, regardless of any prior negotiations. This Agreement shall not be amended or otherwise changed through a writing, signed by both Lessor and Lessee.

49.

The parties shall agree to first attempt mediation of any disputes, with an agreed to mediator and his/her cost shared equally by the parties. If said mediation does not occur within 30 days of the dispute arising, then either party may proceed to Court. Notwithstanding the foregoing, lessor shall not be obligated to engage in mediation for any cause of action seeking possession and/or rents owed by Lessee. In such cases, the Civil code and the Code of Civil Procedure shall govern the dispute resolution.


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RENT ADJUSTMENT(S)
STANDARD LEASE ADDENDUM

Dated DECEMBER 12, 2013

By and Between (Lessor) HILLSIDE ASSOCIATES II, LLC

(Lessee) AEROVIRONMENT, INC., A DELAWARE CORPORATION

Address of Premises: 996 FLOWER GLEN STREET
SIMI VALLEY, CA 93065

Paragraph

A. RENT ADJUSTMENTS:

The monthly rent for each month of the adjustment period(s) specified below shall be increased using the method(s) indicated below.
(Check Method(s) to be Used and Fill in Appropriately)

I. Cost of Living Adjustment(s) (COLA)

a. On (Fill in COLA Dates): N/A

The Base Rent shall be adjusted by the change, if any, from the Base Month specified below, in the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor for (select one): [] CPI W (Urban Wage Earners and Clerical Workers) or [] CPI U (All Urban Consumers), for (Fill in Urban Area):

N/A

All Items

(1982-1984 = 100), herein referred to as "CPI".

b. The monthly rent payable in accordance with paragraph A.I.a. of this Addendum shall be calculated as follows: the Base Rent set forth in paragraph 1.5 of the attached Lease, shall be multiplied by a fraction the numerator of which shall be the CPI of the calendar month 2 months prior to the month(s) specified in paragraph A.I.a. above during which the adjustment is to take effect, and the denominator of which shall be the CPI of the calendar month which is 2 months prior to (select one): the [] first month of the term of this Lease as set forth in paragraph 1.3 ("Base Month") or [] (Fill in Other "Base Month"): N/A. The sum so calculated shall constitute the new monthly rent hereunder, but in no event, shall any such new monthly rent be less than the rent payable for the month immediately preceding the rent adjustment.

c. In the event the compilation and/or publication of the CPI shall be transferred to any other governmental department or bureau or agency or shall be discontinued, then the index most nearly the same as the CPI shall be used to make such calculation. In the event that the Parties cannot agree on such alternative index, then the matter shall be submitted for decision to the American Arbitration Association in accordance with the then rules of said Association and the decision of the arbitrators shall be binding upon the parties. The cost of said Arbitration shall be paid equally by the Parties.

II. Market Rental Value Adjustment(s) (MRV)

a. On (Fill in MRV Adjustment Date(s)): N/A

The Base Rent shall be adjusted to the "Market Rental Value" of the property as follows:

1) Four months prior to each Market Rental Value Adjustment Date described above, the Parties shall attempt to agree upon what the new MRV will be on the adjustment date. If agreement cannot be reached within thirty days, then:

(a) Lessor and Lessee shall immediately appoint a mutually acceptable appraiser or broker to establish the new MRV within the next 30 days. Any associated costs will be split equally between the Parties, or

(b) Both Lessor and Lessee shall each immediately make a reasonable determination of the MRV and submit such determination, in writing, to arbitration in accordance with the following provisions:

(i) Within 15 days thereafter, Lessor and Lessee shall each select an [] appraiser or [] broker ("Consultant" - check one) of their choice to act as an arbitrator. The two arbitrators so appointed shall immediately select a third mutually acceptable Consultant to act as a third arbitrator.

(ii) The 3 arbitrators shall within 30 days of the appointment of the third arbitrator reach a decision as to what the actual MRV for the Premises is, and whether Lessor's or Lessee's submitted MRV is the closest thereto. The decision of a majority of the arbitrators shall be binding on the Parties. The submitted MRV which is determined to be the closest to the actual MRV shall thereafter be used by the Parties.

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(iii) If either of the Parties fails to appoint an arbitrator within the specified 15 days, the arbitrator timely appointed by one of them shall reach a decision on his or her own, and said decision shall be binding on the Parties.

(iv) The entire cost of such arbitration shall be paid by the party whose submitted MRV is not selected, i.e., the one that is NOT the closest to the actual MRV.

2) Notwithstanding the foregoing, the new MRV shall not be less than the rent payable for the month immediately preceding the rent adjustment.

b. Upon the establishment of each New Market Rental Value:

1) the new MRV will become the new "Base Rent" for the purpose of calculating any further Adjustments, and

2) the first month of each Market Rental Value term shall become the new "Base Month" for the purpose of calculating any further Adjustments.

III. Fixed Rental Adjustment(s) (FRA)

The Base Rent shall be increased to the following amounts on the dates set forth below:

| On (Fill in FRA Adjustment Date(s)): | The New Base Rent shall be: |
|--------------------------------------|-----------------------------|
| DECEMBER 1, 2013 | \$27,525.00 |
| DECEMBER 1, 2015 | \$28,764.00 |
| DECEMBER 1, 2017 | \$30,058.00 |
| DECEMBER 1, 2019 | \$31,411.00 |
| _____ | _____ |
| _____ | _____ |
| _____ | _____ |
| _____ | _____ |

B. NOTICE:

Unless specified otherwise herein, notice of any such adjustments, other than Fixed Rental Adjustments, shall be made as specified in paragraph 23 of the Lease.

C. ~~BROKER'S FEE:~~

~~The Broker shall be paid a Brokerage Fee for each adjustment specified above in accordance with paragraph 16 of the Lease.~~

NOTICE: These forms are often modified to meet changing requirements of law and industry needs. Always write or call to make sure you are utilizing the most current form: AIR Commercial Real Estate Association, 800 W 6th Street, Suite 800, Los Angeles, CA 90017. Telephone No. (213) 687-6777. Fax No.: (213) 687-8616.

INITIALS


INITIALS
FORM RA-3-8/00E

RENT CONCESSION AGREEMENT

This document shall set-forth the agreement of **HILLSIDE ASSOCIATES II, LLC, a California Liability Company** Lessor, and **AEROVIRONMENT, INC., a Delaware Corporation**, Lessee concerning the Rent Concessions offered to Lessee in connection with that certain Lease dated **DECEMBER 12, 2013** by and between Lessor and Lessee for the premises located at: **996 FLOWER GLEN STREET** City of **SIMI VALLEY**, State of California (the "Lease").

AS MATERIAL CONSIDERATION for the Rent Concession set-forth herein is Lessee's agreement to lease the Premises on the terms and provisions of the Lease for the entire Lease term. Lessee acknowledges that the Free Rent as set-forth below (herein called "Rent Concession") is a concession given to Lessee for leasing the Premises for the term stated in the Lease Agreement. In the event Lessee becomes in default of any material Lease provision at any time during the Lease term and has not cured such default within the applicable Notice and Cure periods in the lease, Lessor and Lessee agree that: (a) in addition to any other remedy available to Lessor, Lessor shall be entitled to recover from Lessee the unamortized rental amount of any received Rental Concessions taken by Lessee prior to such default date, (b) Lessee agrees to pay such amount to Lessor with the next rental payment. Lessee shall be entitled to the Free Rent and/or Rent Concession(s) provided below for the applicable period of time referenced below:

| | |
|---|---------------------|
| DECEMBER 1, 2013 THROUGH DECEMBER 31, 2013 | \$ 13,762.50 |
| JANUARY 1, 2014 THROUGH JANUARY 31, 2014 | \$ 27,525.00 |
| FEBRUARY 1, 2014 THROUGH FEBRUARY 28, 2014 | \$ 27,525.00 |
| MARCH 1, 2014 THROUGH MARCH 31, 2014 | \$ 27,525.00 |
| APRIL 1, 2014 THROUGH APRIL 30, 2014 | \$ 13,762.50 |
| MAY 1, 2014 THROUGH MAY 31, 2014 | \$ 13,762.50 |
| JUNE 1, 2014 THROUGH JUNE 30, 2014 | \$ 3,030.50 |
| NOVEMBER 1, 2014 THROUGH NOVEMBER 30, 2014 | \$ 13,762.50 |
| DECEMBER 1, 2014 THROUGH DECEMBER 31, 2014 | \$ 13,762.50 |
| JANUARY 1, 2015 THROUGH JANUARY 31, 2015 | \$ 13,762.50 |
| FEBRUARY 1, 2015 THROUGH FEBRUARY 28, 2015 | \$ 13,762.50 |
| MARCH 1, 2015 THROUGH MARCH 31, 2015 | \$ 13,762.50 |

No NNN as defined in the lease shall be abated by the Rent Concession.

Rent Concession(s) referenced above equal a fair rental value in a sum as determined at the time the Rent Concession commences.

THIS DOCUMENT shall not be deemed binding upon Lessor unless and until it is executed by Lessor and a copy delivered to Lessee.

Dated this 18 day of December, 2013.

LESSOR:
HILLSIDE ASSOCIATES II, LLC
A California Limited Liability Company
By **MID VALLEY PROPERTIES,**
Managing Agent

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

BY: /s/ Margaret M. Kestly
Margaret M. Kestly, Authorized Agent

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN

OPTION TO RENEW

Tenant is granted one option to extend the lease for a period of Five (5) years commencing immediately after the expiration of the basic lease term. It shall be the obligation of the tenant to notify the Landlord of its intention to exercise its option to renew within the period between 270 days and 360 days prior to the day that the current lease expires. The notification of the intent to exercise its option shall be sent by tenant in writing by U.S. mail certified, overnight courier delivery or registered with return receipt requested.

The commencement rent for the first month of the option period shall be equal to comparable market rent for a similar building located within a ten-mile radius of the lease property giving consideration to all concessions, tenant improvement allowance and rental abatement for a non-renewal and non-sublease space. In analyzing the comparable building properties, the parties may take into account all factors including ceiling height, parking ratio, loading docks, loading doors and height/size of those doors, HVAC, office build out, electrical power and distribution, skylights, yard space, the general location and the view from inside the building.

Upon receipt within the time period spelled out above and the tenant's exercise of its option to extend said lease both parties will meet and confer in an attempt to arrive at the beginning rent during the option period. If the parties are not able to agree on the option period rent, each party shall designate a licensed real estate broker who has dealt with industrial property in the Simi Valley for not less than 5 years from the date of his appointment, and is at that time employed by an established real estate brokerage firm. If both brokers are unable to agree on the reasonable commencement rent for the option period, then both brokers will attempt to designate a third broker with qualifications at least as stringent as those required of the original brokers. Said third broker shall be given all of the material used by the original brokers to base their reasonable market value, and said broker shall make his own investigation. The third broker then shall select the opinion of one broker as the most correct value, and the value selected by said third broker shall be binding upon the parties.

If two original brokers cannot agree on a third broker, or if the third broker is unacceptable to the parties as defined herein, then either party may request that the presiding judge of the Superior Court of the County of Ventura select a commercial real estate broker from the list usually kept by said presiding judge, and said appointed brokers opinion shall be absolutely binding on all parties.

Any outside broker representing the tenant will receive a 2.5% commission for the option term, payable by Landlord.

If Lessee is in monetary default on the date of giving the option notice or at any time prior to the commencement of the renewal term, the option notice shall be totally ineffective and this Lease shall expire at the end of the initial term.

Notwithstanding the foregoing, the new Market Rent Value shall not be less than the rent payable for the month immediately preceding the rent adjustment.

Dated this 18 day of December, 2013.

LESSOR:
HILLSIDE ASSOCIATES II, LLC
A California Limited Liability Company

LESSEE:
AEROVIRONMENT, INC.
A Delaware Corporation

By MID VALLEY PROPERTIES,
Managing Agent

BY: /s/ Margaret M. Kestly
Margaret M. Kestly, Authorized Agent

BY: /s/ Cathleen S. Cline
CATHLEEN S. CLINE
VP, ADMIN

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

I, Timothy E. Conver, 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: March 4, 2014

/s/ Timothy E. Conver

Timothy E. Conver
Chairman, Chief Executive Officer and President

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

I, Jikun Kim, 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: March 4, 2014

/s/ Jikun Kim

Jikun Kim
Senior Vice President and Chief Financial Officer

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 January 25, 2014 (the "Periodic Report") of the Company fully complies with the requirements of Section 13(a) 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/ Timothy E. Conver
Timothy E. Conver
Chairman, Chief Executive Officer and President

/s/ Jikun Kim
Jikun Kim
Senior Vice President and Chief Financial Officer

Dated: March 4, 2014

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.
