NAVIDEA BIOPHARMACEUTICALS, INC.
Form 10-Q
August 11, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2014

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

For the transition period from to to

Commission File Number: 001-35076

NAVIDEA BIOPHARMACEUTICALS, INC.
(Exact name of registrant as specified in its charter)

Delaware	31-1080091
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
5600 Blazer Parkway, Suite 200, Dublin, Ohio	43017-7550
(Address of principal executive offices)	(Zip Code)

(614) 793-7500
(Registrant's telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 150,635,893 shares of common stock, par value $.001 per share (as of the close of business on August 1, 2014).

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PART I – Financial Information

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Navidea Biopharmaceuticals, Inc. and Subsidiaries
Consolidated Balance Sheets

ASSETS	June 30, 2014	December 31, 2013
	(unaudited)	
Current assets:		
Cash	$17,471,780	$32,939,026
Accounts receivable	487,149	1,150,626
Inventory	1,905,763	2,232,436
Prepaid expenses and other	700,561	1,009,094
Total current assets	20,565,253	37,331,182
Property and equipment	4,117,744	3,609,059
Less accumulated depreciation and amortization	1,354,816	1,483,676
	2,762,928	2,125,383
Patents and trademarks	159,848	163,302
Less accumulated amortization	33,402	26,448
	126,446	136,854
Deferred debt issuance costs and other	133,698	723,098
Total assets	$23,588,325	$40,316,517

Continued

Navidea Biopharmaceuticals, Inc. and Subsidiaries
Consolidated Balance Sheets, continued

LIABILITIES AND STOCKHOLDERS' DEFICIT	June 30, 2014	December 31, 2013
	(unaudited)	
Current liabilities:		
Accounts payable	$1,674,071	$2,422,349
Accrued liabilities and other	3,695,795	4,772,963
Notes payable, current, net of discounts of $809,560 and $743,062, respectively	782,512	4,095,650
Total current liabilities	6,152,378	11,290,962
Notes payable, net of discounts of $1,939,637 and $856,746, respectively	30,438,739	23,572,603
Derivative liabilities	7,689,550	7,692,087
Other liabilities	3,142,933	1,770,452
Total liabilities	47,423,600	44,326,104
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock; $.001 par value; 5,000,000 shares authorized; 3,143 and 7,565 Series B shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	3	8
Common stock; $.001 par value; 200,000,000 shares authorized; 150,635,893 and 135,919,423 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	150,636	135,919
Additional paid-in capital	315,234,175	313,111,788
Accumulated deficit	(339,220,089)	(317,257,302)
Total stockholders' deficit	(23,835,275)	(4,009,587)
Total liabilities and stockholders' deficit	$23,588,325	$40,316,517

See accompanying notes to consolidated financial statements (unaudited).

Navidea Biopharmaceuticals, Inc. and Subsidiaries
Consolidated Statements of Operations
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue:				
Net sales	$1,046,257	$127,821	$1,672,888	$127,821
Grant revenue	28,433	67,456	153,606	67,456
Total revenue	1,074,690	195,277	1,826,494	195,277
Cost of goods sold	270,498	105,438	463,718	105,438
Gross profit	804,192	89,839	1,362,776	89,839
Operating expenses:				
Research and development	5,112,098	4,376,833	10,338,892	8,016,590
Selling, general and administrative	4,907,652	4,169,437	8,818,485	7,533,927
Total operating expenses	10,019,750	8,546,270	19,157,377	15,550,517
Loss from operations	(9,215,558)	(8,456,431)	(17,794,601)	(15,460,678)
Other income (expense):				
Interest income	5,019	1,962	11,812	3,459
Interest expense	(914,070)	(465,268)	(1,857,908)	(828,350)
Change in fair value of financial instruments	(92,332)	—	300,151	—
Loss on extinguishment of debt	—	(1,372,266)	(2,610,196)	(1,372,266)
Other, net	(5,293)	(8,348)	(12,045)	16,465
Total other expense, net	(1,006,676)	(1,843,920)	(4,168,186)	(2,180,692)
Net loss attributable to common stockholders	$(10,222,234)	$(10,300,351)	$(21,962,787)	$(17,641,370)
Loss per common share (basic and diluted)	$(0.07)	$(0.09)	$(0.15)	$(0.15)
Weighted average shares outstanding (basic and diluted)	150,019,939	118,260,288	147,416,111	116,024,366

See accompanying notes to consolidated financial statements (unaudited).

Navidea Biopharmaceuticals, Inc. and Subsidiaries
Consolidated Statement of Stockholders' Deficit
(unaudited)

	Preferred Stock		Common Stock		Additional Paid-In	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Deficit	Total
Balance, December 31, 2013	7,565	$8	135,919,423	$135,919	$313,111,788	$(317,257,302)	$(4,009,587)
Issued stock upon exercise of stock options, net			235,075	235	(5,644)		(5,409)
Issued restricted stock			160,000	160			160
Canceled forfeited restricted stock	—	—	(175,000)	(175)	—	—	(175)
Issued stock to 401(k) plan	—	—	36,455	37	100,007	—	100,044
Conversion of Series B preferred stock to common stock	(4,422)	(5)	14,459,940	14,460	(14,455)		—
Issued warrants in connection with debt issuance					464,990		464,990
Recovery of shareholder short swing profits					17,554		17,554
Stock compensation expense					1,559,935		1,559,935
Net loss						(21,962,787)	(21,962,787)
Balance, June 30, 2014	3,143	$3	150,635,893	$150,636	$315,234,175	$(339,220,089)	$(23,835,275)

See accompanying notes to consolidated financial statements (unaudited).

Navidea Biopharmaceuticals, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net loss	$(21,962,787)	$(17,641,370)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	235,356	234,607
Loss on disposal and abandonment of assets	28,681	—
Amortization of debt discount and issuance costs	436,824	243,139
Stock compensation expense	1,559,935	1,422,125
Change in fair value of financial instruments	(300,151)	—
Loss on extinguishment of debt	2,610,196	1,372,266
Issued stock to 401(k) plan	100,044	66,777
Changes in operating assets and liabilities:		
Accounts receivable	663,477	(66,714)
Inventory	326,673	(1,032,252)
Prepaid expenses and other assets	194,694	(491,496)
Accounts payable	(748,278)	1,469,723
Accrued and other liabilities	(737,089)	(328,021)
Net cash used in operating activities	(17,592,425)	(14,751,216)
Cash flows from investing activities:		
Purchases of equipment	(1,108,164)	(672,046)
Patent and trademark costs	(14,361)	(16,948)
Net cash used in investing activities	(1,122,525)	(688,994)
Cash flows from financing activities:		
Proceeds from issuance of common stock and short swing profits	88,064	11,303,767
Payment of common stock issuance costs	—	(668,064)
Payment of tax withholdings related to stock-based compensation	(75,759)	(659,018)
Proceeds from notes payable	30,000,000	29,000,000
Payment of debt-related costs	(1,763,526)	(1,111,181)
Principal payments on notes payable	(25,000,000)	(5,901,335)
Payments under capital leases	(1,075)	(4,218)
Net cash provided by financing activities	3,247,704	31,959,951
Net (decrease) increase in cash	(15,467,246)	16,519,741
Cash, beginning of period	32,939,026	9,118,564
Cash, end of period	$17,471,780	$25,638,305

See accompanying notes to consolidated financial statements (unaudited).

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Notes to the Consolidated Financial Statements (unaudited)

1. Summary of Significant Accounting Policies

a. Basis of Presentation: The information presented as of June 30, 2014 and for the three-month and six-month periods ended June 30, 2014 and 2013 is unaudited, but includes all adjustments (which consist only of normal recurring adjustments) that the management of Navidea Biopharmaceuticals, Inc. (Navidea, the Company, or we) believes to be necessary for the fair presentation of results for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. The balances as of June 30, 2014 and the results for the interim periods are not necessarily indicative of results to be expected for the year. The consolidated financial statements should be read in conjunction with Navidea's audited consolidated financial statements for the year ended December 31, 2013, which were included as part of our Annual Report on Form 10-K.

Our consolidated financial statements include the accounts of Navidea and our wholly owned subsidiaries, Navidea Biopharmaceuticals Limited and Cardiosonix Ltd. All significant inter-company accounts were eliminated in consolidation.

b. Financial Instruments and Fair Value: In accordance with current accounting standards, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 – Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly; and

Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. In determining the appropriate levels, we perform a detailed analysis of the assets and liabilities whose fair value is measured on a recurring basis. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs or instruments which trade infrequently and therefore have little or no price transparency are classified as Level 3. See Note 2.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

(1) Cash, accounts receivable, accounts payable, and accrued liabilities: The carrying amounts approximate fair value because of the short maturity of these instruments.

(2) Notes payable: The carrying value of our debt at June 30, 2014 and December 31, 2013 primarily consists of the face amount of the notes less unamortized discounts. See Note 7. At June 30, 2014 and December 31, 2013, certain notes payable were also required to be recorded at fair value. The estimated fair value of our debt was calculated using a discounted cash flow analysis as well as a probability-weighted Monte Carlo simulation. These valuation methods include Level 3 inputs such as the estimated current market interest rate for similar instruments with similar creditworthiness. Unrealized gains and losses on the fair value of the debt are classified in other expenses as a change in the fair value of financial instruments in the consolidated statements of operations. At June 30, 2014,

the fair value of our notes payable is approximately $35.6 million.

(3) Derivative liabilities: Derivative liabilities are related to certain outstanding warrants which are recorded at fair value. The assumptions used to calculate fair value as of June 30, 2014 include volatility, a risk-free rate and expected dividends. In addition, we considered non-performance risk and determined that such risk is minimal. Unrealized gains and losses on the derivatives are classified in other expenses as a change in the fair value of financial instruments in the consolidated statements of operations. See Notes 2 and 8.

c. Revenue Recognition: We currently generate revenue primarily from sales of Lymphoseek. Our standard shipping terms are FOB shipping point, and title and risk of loss passes to the customer upon delivery to a carrier for shipment from Cardinal Health’s national distribution center to another point of destination. We generally recognize sales revenue related to sales of our products when the products are shipped. Our customers have no right to return products purchased in the ordinary course of business.

We earn additional revenues based on a percentage of the actual net revenues achieved by Cardinal Health on sales to end customers made during each fiscal year. The amount we charge Cardinal Health related to end customer sales of Lymphoseek are subject to a retroactive annual adjustment. To the extent that we can reasonably estimate the end-customer prices received by Cardinal Health, we record sales based upon these estimates at the time of sale. If we are unable to reasonably estimate end customer sales prices related to products sold, we record revenue related to these product sales at the minimum (i.e., floor) price provided for under our distribution agreement with Cardinal Health.

We generate additional revenue from grants to support various product development initiatives. We generally recognize grant revenue when expenses reimbursable under the grants have been incurred and payments under the grants become contractually due.

d. Recent Accounting Pronouncements: In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. The core principle of ASU 2014-09 is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, ASU 2014-09 requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies a performance obligation. Entities will generally be required to make more estimates and use more judgment than under current guidance, which will be highlighted for users through increased disclosure requirements. ASU 2014-09 is effective for public entities for annual periods beginning after December 15, 2016, including interim periods therein. Three basic transition methods are available - full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Early adoption is prohibited. We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our consolidated financial statements and have not yet determined the method by which we will adopt the standard in 2017.

In June 2014, the FASB issued ASU No. 2014-12, Compensation-Stock Compensation. ASU 2014-12 requires that a performance target included in a share-based payment award that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Therefore, under the existing stock compensation guidance for in Topic 718, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 is effective for annual periods beginning after December 15, 2015, including interim periods therein. Earlier adoption is permitted. Entities may apply the amendments in ASU 2014-12 either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying ASU 2014-12 as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. We do not expect the adoption of ASU 2014-12 to have a material effect on our consolidated financial statements.

2. Fair Value Hierarchy

Beginning in the second quarter of 2013, Platinum-Montaur Life Sciences, LLC (Platinum) has the right to convert all or any portion of the unpaid principal or unpaid interest accrued on any future draws under the Platinum credit facility, under certain circumstances. Platinum's option to convert future draws into common stock was determined to meet the definition of a liability and is included as part of the value of the related notes payable on the consolidated balance sheet. The estimated fair value of the Platinum notes payable is $4.0 million at June 30, 2014, and will continue to be measured on a recurring basis. See Note 8.

In September 2013, in connection with a Securities Purchase Agreement with Crede CG III, Ltd. (Crede), we issued warrants containing certain features that, although they do not require the warrants to be settled in cash, do require the warrants to be classified as liabilities under applicable accounting rules. As a result, the Company recorded a derivative liability with an estimated fair value of $7.7 million on the date the warrants were issued. The estimated fair value of the liability remained at $7.7 million as of June 30, 2014, and will continue to be measured on a recurring basis. See Notes 1b(3) and 8.

The following tables set forth, by level, financial liabilities measured at fair value on a recurring basis:

Liabilities Measured at Fair Value on a Recurring Basis as of June 30, 2014

Description	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of June 30, 2014
Platinum notes payable	$—	$—	$3,970,448	$3,970,448
Derivative liabilities related to warrants	—	7,689,550	—	7,689,550

Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2013

Description	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2013
Platinum notes payable	$—	$—	$4,268,062	$4,268,062
Derivative liabilities related to warrants	—	7,692,087	—	7,692,087

a. Valuation Processes-Level 3 Measurements: Depending on the instrument, the Company utilizes discounted cash flows, option pricing models, or third-party valuation services to estimate the value of their financial assets and liabilities. Valuations using discounted cash flow methods and certain option pricing models such as Black-Scholes are generally conducted by the Company. Valuations using complex models such as Monte Carlo simulation are generally provided to the Company by third-party valuation experts. Each reporting period, the Company provides significant unobservable inputs to the third-party valuation experts based on current internal estimates and forecasts.

b. Sensitivity Analysis-Level 3 Measurements: Changes in the Company’s current internal estimates and forecasts are likely to cause material changes in the fair value of the liabilities. The significant unobservable inputs used in the fair value measurement of the liabilities are the amount and timing of future draws expected to be taken under the Platinum Loan Agreement based on current internal forecasts, management’s estimate of the likelihood of actually making those draws as opposed to obtaining other sources of financing, and management’s estimate of the likelihood of those draws ultimately resulting in Platinum exercising their conversion option under the Platinum Loan Agreement. Significant increases (decreases) in any of the significant unobservable inputs would result in a higher (lower) fair value measurement. A change in one of the inputs would not necessarily result in a directionally similar change in the others.

There were no Level 1 liabilities outstanding at any time during the three-month and six-month periods ended June 30, 2014 and 2013. There were no transfers in or out of our Level 2 liabilities during the three-month and six-month periods ended June 30, 2014 or 2013.

3. Stock-Based Compensation

At June 30, 2014, we have instruments outstanding under two stock-based compensation plans; the 1996 Stock Incentive Plan (the 1996 Plan) and the Fourth Amended and Restated 2002 Stock Incentive Plan (the 2002 Plan). Currently, under the 2002 Plan, we may grant incentive stock options, nonqualified stock options, and restricted stock awards to full-time employees and directors, and nonqualified stock options and restricted stock awards may be granted to our consultants and agents. Total shares authorized under each plan are 1.5 million shares and 12 million shares, respectively. Although instruments are still outstanding under the 1996 Plan, the plan has expired and no new grants may be made from it. Under both plans, the exercise price of each option is greater than or equal to the closing market price of our common stock on the date of the grant.

Stock options granted under the 1996 Plan and the 2002 Plan generally vest on an annual basis over one to four years. Outstanding stock options under the plans, if not exercised, generally expire ten years from their date of grant or up to 90 days following the date of an optionee's separation from employment with the Company. We issue new shares of our common stock upon exercise of stock options.

Stock-based payments to employees and directors, including grants of stock options, are recognized in the consolidated statements of operations based on their estimated fair values. The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option pricing model. Expected volatilities are based on the Company's historical volatility, which management believes represents the most accurate basis for estimating expected future volatility under the current circumstances. Navidea uses historical data to estimate forfeiture rates. The expected term of stock options granted is based on the vesting period and the contractual life of the options. The risk-free rate is based on the U.S. Treasury yield in effect at the time of the grant.

Compensation cost arising from stock-based awards is recognized as expense over either (1) the requisite service period or (2) the estimated performance period. Restricted stock awards are valued based on the closing stock price on the date of grant and amortized ratably over the estimated life of the award. Restricted stock may vest based on the passage of time, or upon occurrence of a specific event or achievement of goals as defined in the grant agreements. In such cases, we record compensation expense related to grants of restricted stock based on management's estimates of the probable dates of the vesting events.

For the three-month periods ended June 30, 2014 and 2013, our total stock-based compensation expense was approximately $867,000 and $679,000, respectively. For the six-month periods ended June 30, 2014 and 2013, our total stock-based compensation expense was approximately $1.6 million and $1.4 million, respectively. We have not recorded any income tax benefit related to stock-based compensation in any of the three-month or six-month periods ended June 30, 2014 and 2013.

A summary of the status of our stock options as of June 30, 2014, and changes during the six-month period then ended, is presented below:

	Six Months Ended June 30,			
	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at beginning of period	4,866,602	$2.38		
Granted	1,468,230	1.77		
Exercised	(323,000)	0.50		
Canceled and Forfeited	(33,650)	2.52		
Expired	(120,000)	0.53		
Outstanding at end of period	5,858,182	$2.37	7.8 years	$619,590
Exercisable at end of period	2,623,736	$2.21	6.5 years	$619,590

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A summary of the status of our unvested restricted stock as of June 30, 2014, and changes during the six-month period then ended, is presented below:

	Six Months Ended June 30,	
	Number of Shares	Weighted Average Grant-Date Fair Value
Unvested at beginning of period	634,250	$2.73
Granted	160,000	1.79
Vested	(149,000)	3.16
Forfeited	(175,000)	1.77
Expired	—	—
Unvested at end of period	470,250	$2.63

In February 2014, 49,000 shares of restricted stock held by non-employee directors with an aggregate fair value of $96,000 vested as scheduled according to the terms of the restricted stock agreements. In March 2014, 100,000 shares of restricted stock with an aggregate fair value of $205,000 vested as scheduled according to the terms of a restricted stock agreement. In May 2014, 175,000 shares of restricted stock held by our former CEO with an aggregate fair value of $278,000 were forfeited in connection with his separation from employment.

As of June 30, 2014, there was approximately $2.1 million of total unrecognized compensation expense related to unvested stock-based awards, which we expect to recognize over remaining weighted average vesting terms of 2.1 years.

4. Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) attributable to common stockholders by the weighted-average number of common shares and, except for periods with a loss from operations, participating securities outstanding during the period. Diluted earnings (loss) per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company include convertible securities, options and warrants.

Earnings (loss) per common share for the three-month and six-month periods ended June 30, 2014 and 2013 excludes the effects of 18.3 million and 34.5 million common share equivalents, respectively, since such inclusion would be anti-dilutive. The excluded shares consist of common shares issuable upon exercise of outstanding stock options and warrants, and upon the conversion of convertible debt and convertible preferred stock.

The Company’s unvested stock awards contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid (referred to as “participating securities”). Therefore, the unvested stock awards are required to be included in the number of shares outstanding for both basic and diluted earnings per share calculations. However, due to our loss from continuing operations, 470,000 and 651,000 shares of unvested restricted stock were excluded in determining basic and diluted loss per share for the three-month and six-month periods ended June 30, 2014 and 2013, respectively, because such inclusion would be anti-dilutive.

5. Inventory

All components of inventory are valued at the lower of cost (first-in, first-out) or market. We adjust inventory to market value when the net realizable value is lower than the carrying cost of the inventory. Market value is determined based on estimated sales activity and margins.

The components of inventory as of June 30, 2014 and December 31, 2013, with no reserves recorded for either period, are as follows:

	June 30, 2014	December 31, 2013
	(unaudited)	
Materials	$603,719	$652,818
Work-in-process	1,067,507	1,073,568
Finished goods	234,537	506,050
Total	$1,905,763	$2,232,436

During the three-month and six-month periods ended June 30, 2013, we capitalized $545,000 and $1.1 million, respectively, of inventory costs associated with our Lymphoseek® (technetium Tc 99m tilmanocept) Injection product. The Company capitalized no such costs during the same period in 2014. During the three-month and six-month periods ended June 30, 2014, we wrote off $45,000 and $55,000, respectively, of previously capitalized Lymphoseek inventory due to the consumption of the Lymphoseek material for product testing and development purposes.

We estimate a reserve for obsolete inventory based on management's judgment of probable future commercial use, which is based on an analysis of current inventory levels, estimated future sales and production rates, and estimated shelf lives. During the six-month periods ended June 30, 2014 and 2013, we recorded no obsolescence reserve for Lymphoseek inventory.

6. Reduction in Force

In May 2014, the Company's Board of Directors made the decision to refocus the Company's resources to better align the funding of our pipeline programs with the expected growth in Lymphoseek revenue. As a part of the realignment, the Company terminated a total of 11 employees, including the Chief Executive Officer, Dr. Mark J. Pykett. The Company recognized total separation expenses of approximately $1.4 million during the quarter ended June 30, 2014.

Effective May 30, 2014, the Company and Dr. Pykett entered into a Separation Agreement and Release. Following the termination date, Dr. Pykett is entitled to receive a $750,000 severance payment, payable in two equal installments on June 9, 2014, and January 2, 2015, respectively; a single payment for accrued vacation and personal days; and reimbursement for certain other expenses and fees.

Certain of Dr. Pykett's equity awards terminated upon separation, while others were modified in conjunction with the Separation Agreement and the Consulting Agreement described below. The Company recognized approximately $512,000 of compensation expense associated with the modification of Dr. Pykett's equity awards during the quarter ended June 30, 2014.

Effective June 1, 2014, the Company and Dr. Pykett entered into a Consulting Agreement pursuant to which Dr. Pykett will serve as an independent consultant to the Company until December 31, 2014 with respect to clinical-regulatory activities, commercial activities, program management, and business development, among other services. Dr. Pykett is entitled to a consulting fee of $27,500 per month plus reimbursement of reasonable expenses. The Consulting Agreement also provides for a grant of 40,000 shares of restricted stock which vest upon certain service and performance conditions. During the term of the Consulting Agreement and for one year thereafter, Dr. Pykett is prohibited from competing with the Company, including the solicitation of customers or employees of the Company. Dr. Pykett may terminate the Consulting Agreement at any time upon 30 days' prior written notice. The Company recognized expense of $32,000 under the Consulting Agreement during the quarter ended June 30, 2014.

The following table summarizes the remaining accrued separation costs, including estimated employer payroll tax obligations, related to the Company's reduction in force, which are included in accrued liabilities and other on the consolidated balance sheet as of June 30, 2014:

	As of June 30, 2014
Separation	$413,304
Estimated cost of continuing healthcare coverage	60,882
	$474,186

The Company appointed Michael M. Goldberg, M.D., as interim Chief Executive Officer effective May 30, 2014. Dr. Goldberg currently serves as a member of the Board of Directors of the Company and will not receive any salary for his service as interim Chief Executive Officer, although the Company has agreed to pay Montaur Capital Partners, LLC (Montaur), where Dr. Goldberg is principal, $15,000 per month to cover additional costs and resources Montaur will incur or redirect due to the unavailability of Dr. Goldberg's services resulting from his service as interim Chief Executive Officer of Navidea.

7. Notes Payable

In March 2014, we executed a Loan and Security Agreement the (Oxford Loan Agreement) with Oxford Finance, LLC (Oxford), providing for a loan to the Company of $30 million. Pursuant to the Oxford Loan Agreement, we issued Oxford: (1) Term Notes in the aggregate principal amount of $30,000,000, bearing interest at 8.5% (the Oxford Notes), and (2) Series KK warrants to purchase an aggregate of 391,032 shares of our common stock at an exercise price of $1.918 per share, expiring in March 2021 (the Series KK warrants). We will make monthly payments of interest only commencing on April 1, 2014, and continuing on the first calendar day of each successive month thereafter through and including the first calendar day of the month immediately preceding April 1, 2015 (the Amortization Date, which may be extended to April 1, 2016, and again to April 1, 2017, if the Company achieves certain milestones associated with the Company’s Lymphoseek product). Commencing on the Amortization Date, and continuing on the first calendar day of each month thereafter, the Company will make consecutive equal monthly payments of principal and interest, in arrears, to the lenders then party to the Oxford Loan Agreement based on a repayment schedule of 48 months if the Amortization Date is April 1, 2015, 36 months if the Amortization Date is April 1, 2016, and 24 months if the Amortization Date is April 1, 2017. All unpaid principal, and accrued and unpaid interest, with respect to the Oxford Notes is due and payable in full on March 1, 2019. We will also make a final payment to the lenders in an aggregate amount equal to the original principal amount of the loan multiplied by 7.95% if the Amortization Date is April 1, 2015; 8.95% if the Amortization Date is extended to April 1, 2016; or 9.95% if the Amortization Date is extended to April 1, 2017. The Oxford Notes are collateralized by a security interest in substantially all of the Company’s assets except for intellectual property, as to which the security interest is in rights to income or proceeds from the sale or licensing thereof. The Oxford Loan Agreement requires that the Company adhere to certain affirmative and negative covenants, including, without limitation, financial reporting requirements and a prohibition against the incurrence of indebtedness, or creation of additional liens, other than as specifically permitted by the terms of the Oxford Loan Agreement. As of June 30, 2014, the outstanding principal balance of the Oxford Loan Agreement was $30 million, and we were in compliance with all covenants of the Oxford Loan Agreement.

The Company recorded a debt discount related to the issuance of the Series KK Warrants and other fees to the lenders totaling $3.0 million. Debt issuance costs directly attributable to the Oxford Loan Agreement, totaling $120,000, were recorded as a non-current asset on the consolidated balance sheet on the closing date. The debt discount and debt offering costs are being amortized as non-cash interest expense using the effective interest method over the term of the Oxford Loan Agreement. As of June 30, 2014, the balance of the debt discount was $2.7 million, and the balance of the debt issuance costs was $108,000.

Also in March 2014, in connection with the consummation of the Oxford Loan Agreement, we repaid all amounts outstanding under the General Electric Capital Corporation (GECC) and MidCap Financial SBIC, LP (MidCap) Loan and Security Agreement for a payoff amount of $26.7 million, which included payments of $500,000 as a pre-payment fee and $1,000,000 as an end-of-term final payment fee.

In March 2014, in connection with entering into the Oxford Loan Agreement, we entered into a second amendment to the Platinum Loan Agreement (the Second Platinum Amendment). Concurrent with the execution of the Second Platinum Amendment, the Company delivered an Amended and Restated Promissory Note (the Second Amended Platinum Note) to Platinum, which amended and restated the First Amended Platinum Note. The Second Amended Platinum Note adjusted the interest rate to the greater of (i) the United States prime rate as reported in The Wall Street Journal plus 6.75%, (ii)

10.0%, and (iii) the highest rate of interest then payable by the Company pursuant to the Oxford Loan Agreement plus 0.125%. Navidea, Platinum, and Oxford also entered into a Subordination Agreement, providing for subordination of the Company's indebtedness under the Platinum Loan Agreement to the Company's indebtedness under the Oxford Loan Agreement, among other customary terms and conditions. As such, no payments may be made under the Platinum loan until the Oxford Notes have been paid in full and therefore, the current balance outstanding under the Platinum loan has been classified as long-term notes payable to coincide with the maturity of the Oxford Notes. The fair value of the Second Amended Platinum Note includes the estimated fair value of an embedded conversion option. The net decrease in the estimated fair value of the Second Amended Platinum Note of $298,000 was recorded as a non-cash change in fair value of financial instruments during the six-month period ended June 30, 2014. The estimated fair value of the Second Amended Platinum Note was $3.9 million as of June 30, 2014. As of June 30, 2014, the remaining outstanding principal balance of the Second Amended Platinum Note was approximately $3.2 million, with $31.8 million still available under the credit facility.

During the three-month periods ended June 30, 2014 and 2013, we recorded interest expense of $914,000 and $465,000, respectively, related to our notes payable. Of these amounts, $195,000 and $121,000, respectively, related to amortization of the debt discounts and deferred financing costs related to our notes payable. During the six-month periods ended June 30, 2014 and 2013, we recorded interest expense of $1.9 million and $828,000, respectively, related to our notes payable. Of these amounts, $437,000 and $243,000, respectively, related to amortization of the debt discounts and deferred financing costs related to our notes payable.

In July 2014, in connection with entering into the R-NAV joint enterprise (see Note 13), we entered into an amendment to the Oxford Loan Agreement that amended certain covenants to permit our investment in R-NAV, and R-NAV entered into a Subordination Agreement with Oxford to subordinate our indebtedness to R-NAV to our obligations under the Oxford Loan Agreement.

8. Derivative Instruments

Certain embedded features of our convertible securities and notes payable, as well as warrants to purchase our common stock, may be treated as derivative liabilities. The estimated fair values of the derivative liabilities are recorded as non-current liabilities on the consolidated balance sheet. Changes in the estimated fair values of the derivative liabilities are recorded in the consolidated statement of operations as non-cash income (expense). We do not use derivative instruments for hedging of market risks or for trading or speculative purposes.

At June 30, 2014, derivative liabilities consist of the Series JJ warrants issued to Crede in September 2013. The net effect of marking the Company's derivative liabilities to market during the three-month and six-month periods ended June 30, 2014 resulted in net decreases in the estimated fair values of the derivative liabilities of approximately $4,000 and $3,000, respectively, which were recorded as non-cash changes in the fair value of financial instruments. The total estimated fair value of our derivative liabilities was $7.7 million as of June 30, 2014. No derivative liabilities were outstanding as of December 31, 2013. See Notes 1b(3) and 2.

9. Equity

During the six-month period ended June 30, 2014, Platinum converted 4,422 shares of their Series B Preferred Stock into 14,459,940 shares of our common stock under the terms of the Series B Preferred Stock. As of June 30, 2014, there are 3,143 shares of Series B Preferred Stock outstanding which are convertible into 10,277,610 shares of our common stock.

10. Stock Warrants

In March 2014, in connection with the Oxford Loan Agreement, the Company issued Series KK warrants to purchase an aggregate of 391,032 shares of our common stock at an exercise price of $1.918 per share, expiring in March 2021.

At June 30, 2014, there are 4.9 million warrants outstanding to purchase our common stock. The warrants are exercisable at prices ranging from $1.918 to $3.83 per share with a weighted average exercise price of $3.27 per share.

11. Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Due to the uncertainty surrounding the realization of the deferred tax assets in future tax returns, all of the deferred tax assets have been fully offset by a valuation allowance at June 30, 2014 and December 31, 2013.

Current accounting standards include guidance on the accounting for uncertainty in income taxes recognized in the financial statements. Such standards also prescribe a recognition threshold and measurement model for the financial statement recognition of a tax position taken, or expected to be taken, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company believes that the ultimate deductibility of all tax positions is highly certain, although there is uncertainty about the timing of such deductibility. As a result, no liability for uncertain tax positions was recorded as of June 30, 2014 or December 31, 2013 and we do not expect any significant changes in the next twelve months. Should we need to accrue interest or penalties on uncertain tax positions, we would recognize the interest as interest expense and the penalties as a selling, general and administrative expense. As of June 30, 2014, tax years 2010-2013 remained subject to examination by federal and state tax authorities.

12. Supplemental Disclosure for Statements of Cash Flows

During the six-month periods ended June 30, 2014 and 2013, we paid interest aggregating $1.4 million and $607,000, respectively. During the six-month periods ended June 30, 2014 and 2013, we issued 36,455 and 22,126 shares of our common stock, respectively, as matching contributions to our 401(k) plan.

In connection with entering into the Oxford Loan Agreement, we issued warrants with an estimated relative fair value of $465,000. In conjunction with the GECC Loan Agreement, we issued warrants with a fair value of $631,000.

13. Subsequent Event

On July 15, 2014, Navidea entered into agreements relating to the formation of a limited liability company, R-NAV, LLC (R-NAV), which will pursue opportunities for use of the Company's Manocept™ CD206 macrophage targeting platform technology in diagnosis and treatment of rheumatologic and arthritic diseases. The participants in R-NAV are Navidea, Rheumco, LLC, a portfolio company of Essex Woodlands Health Ventures, and third party private investors affiliated with Essex Woodlands. Using a combination of the Company’s Manocept technology and Rheumco’s proprietary Tin-117m radioisotope technology, R-NAV will focus on the development of several diagnostic and therapeutic applications in the arthritis space, each to be conducted in a separate subsidiary of R-NAV:

Subsidiary 1:	Detection of rheumatoid arthritis (RA) initially using Tc-99m tilmanocept, commercially known as Lymphoseek® (technetium Tc 99m tilmanocept) Injection,
Subsidiary 2:	Combination of the Manocept platform with Tin-117m for detection and treatment of RA,
Subsidiary 3:	Detection and treatment of human and veterinary osteoarthritis (OA) using the Tin-117m technology, and

Subsidiary 4: Treatment of hemophilic arthropathy (HA), a rare pediatric condition.

The Company has three-year call options to acquire, at its sole discretion, all of the equity of Subsidiary 1 prior to the launch of a Phase 3 clinical trial for its development program, and all of the equity of Subsidiary 2 upon completion of radiochemistry and biodistribution studies for its development program. Both Rheumco and Navidea have contributed licenses for intellectual property and technology to R-NAV in exchange for common units in R-NAV. Each of the licenses has grant-back provisions with respect to inventions and other intellectual property developed in these programs outside of the exclusive fields of use specified in the license.

R-NAV was initially capitalized through a $4 million investment from the investors alongside a $1 million investment from the Company to be paid over three years, with $333,334 in cash contributed at inception and a promissory note in the principal amount of $666,666, payable in two equal installments on the first and second anniversaries of the transaction. The note will bear interest at the applicable federal rate, currently 0.31% per annum. In exchange for its capital and in-kind investment, the Company received 1,000,000 Series A preferred units of R-NAV (Series A Units), and an additional 500,000 Series A Units for management and technical services associated with the programs described above to be performed by the Company for R-NAV pursuant to a services agreement. The Series A Units are convertible into common units at the option of the holder for a conversion price of $1 per unit, subject to broad-based weighted average anti-dilution rights.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting the financial condition of our business. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including, among other things:

- general economic and business conditions, both nationally and in our markets;
- our history of losses, negative net worth and uncertainty of future profitability;
- our ability to successfully complete research and further development of our drug candidates;
- the timing, cost and uncertainty of obtaining regulatory approvals of our drug candidates;
- our ability to successfully commercialize our drug candidates;
- our expectations and estimates concerning future financial performance, financing plans and the impact of competition;
- our ability to raise capital sufficient to fund our development and commercialization programs;
- our ability to implement our growth strategy;
- anticipated trends in our business;
- advances in technologies; and
- other risk factors set forth in this report and detailed in our most recent Annual Report on Form 10-K and other SEC filings.

In addition, in this report, we use words such as “anticipate,” “believe,” “plan,” “expect,” “future,” “intend,” and similar expressions to identify forward-looking statements.

We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this report. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements.

The Company

Navidea Biopharmaceuticals, Inc. (Navidea, the Company, or we), a Delaware corporation, is a biopharmaceutical company focused on the development and commercialization of precision diagnostics. We have five pharmaceutical platforms in various stages of development:

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Lymphoseek® (technetium Tc 99m tilmanocept) Injection is a novel, receptor-targeted, small-molecule radiopharmaceutical used in lymphatic mapping procedures that are performed to help evaluate patients with breast cancer or melanoma. Lymphoseek is designed to identify the lymph nodes that drain from a primary tumor, which have the highest probability of harboring cancer. It was approved by the U.S. Food and Drug Administration (FDA) in March 2013, and launched commercially in the United States in May 2013.

Navidea's Manocept™ platform is predicated on the ability of the backbone of tilmanocept to specifically target the CD206 mannose receptor expressed on macrophages. Building on the success of Lymphoseek, this flexible and versatile platform acts as an engine for the design of purpose-built molecules offering the potential to be utilized across a range of diagnostic modalities, including single photon emission computed tomography (SPECT), positron emission tomography (PET), intra-operative and/or optical-fluorescence detection in a variety of disease states.

- NAV4694 is a Fluorine-18 (F-18) radiolabeled PET imaging agent being developed as an aid in the diagnosis of patients with signs or symptoms of Alzheimer’s disease (AD) and mild cognitive impairment (MCI).
- NAV5001 is an Iodine-123 (I-123) radiolabeled SPECT imaging agent being developed as an aid in the diagnosis of Parkinson’s disease (PD) and other movement disorders, with potential use as a diagnostic aid in dementia.
- NAV1800 (formerly RIGScan™) is being developed as a diagnostic aid for imaging and use during surgery to help surgeons locate occult or metastatic cancer, with a primary focus to date on colorectal cancer.

The last four of these drug product platforms are in development and must be cleared for marketing by the appropriate regulatory authorities before they can be sold in any markets.

Product Line Overview

Our primary development efforts over the last few years have been focused on the development of our now-approved Lymphoseek product, as well as more recently on our other pipeline programs, including NAV4694, NAV5001, NAV1800, and our Manocept platform. In May 2014, the Board of Directors made the decision to refocus the Company's resources to better align the funding of our pipeline programs with the expected growth in Lymphoseek revenue. This realignment primarily involves reducing our near-term support for our two neurological product candidates, NAV4694 and NAV5001, as we seek to secure a development partner or partners for these programs. The Company is also working to establish new sources of non-dilutive funding, including collaborations that can augment the balance sheet as the Company works to reduce spending to levels that can be increasingly offset by growing Lymphoseek revenue. In particular, substantial progress on the Manocept platform has resulted in several promising opportunities, including our recently announced R-NAV venture, which we believe may further expand the Company's pipeline but which require less near-term funding from Navidea than the two ongoing Phase 3 neurological development programs.

Navidea remains committed to expanding the Lymphoseek label and realizing the full potential of the product. We intend to work closely with our partners to continue the strong growth of this important product. The Company believes that the resources being devoted to drive Lymphoseek sales will lead to cash flows that can ultimately fund developmental stage programs from cash flow from operations. The Company is focused on expanding the market for Lymphoseek in all relevant markets.

We expect our overall research and development expenditures to be lower during the second half of 2014 as compared to 2013 due to the refocusing efforts outlined above, as we reduce the near-term scope of development of NAV4694, NAV5001, and NAV1800, while we allocate our resources to personnel, contractors and consultants supporting the global registration and commercialization of Lymphoseek, and development of our Manocept platform.

Lymphoseek

Lymphoseek is a lymph node targeting radiopharmaceutical agent intended for use in intraoperative lymphatic mapping procedures and lymphoscintigraphy employed in the overall diagnostic assessment of certain solid tumor cancers. Lymphoseek has the potential to provide oncology surgeons with information to identify key predictive lymph nodes that may harbor cancer and to help avoid the unnecessary removal of non-cancerous lymph nodes and the surrounding tissue in patients with a variety of solid tumor cancers. Lymphoseek was approved and indicated for use in lymphatic mapping for breast cancer and melanoma by the FDA in March 2013.

In December 2013, the FDA granted Fast Track designation to Lymphoseek for sentinel lymph node detection in patients with head and neck cancer and we submitted a supplemental New Drug Application (sNDA) with the FDA seeking approval for the marketing and sale of Lymphoseek for the same indication. In assessing the data-rich submission, the FDA chose to separate the filing into two applications based on the proposed labeling extensions requested and the scope of information provided. The first sNDA, aimed at Lymphoseek's use as a sentinel lymph node detection agent in patients with head and neck cancer, was accepted for review by the FDA in February 2014, and was granted Priority Review. Under the Prescription Drug User Fee Act (PDUFA), the FDA set a target review date for the first sNDA of June 16, 2014. In March 2014, the FDA accepted for review the second sNDA to support broader and more flexible use of Lymphoseek in imaging and lymphatic mapping procedures, including lymphoscintigraphy and other product capabilities. Under PDUFA, the FDA has set a target review date for the second sNDA of October 16, 2014. On June 13, 2014, the FDA approved the first sNDA for the expanded use of Lymphoseek indicated for guiding sentinel lymph node biopsy in head and neck cancer patients with squamous cell carcinoma of the oral cavity, making Lymphoseek the first and only FDA-approved radiopharmaceutical application for sentinel lymph node detection. Additional trials, including an ongoing trial in colorectal cancer, and others in various stages of execution, planning or consideration, are anticipated to provide additional data to potentially support expansion of the Lymphoseek opportunity. The Company continues to advance the second sNDA through productive discussions with the FDA.

In March 2014, we announced results of a three-year, voluntary follow-up study of Lymphoseek conducted in patients who participated in a Phase 3 clinical trial (NEO3-05) of the product. The primary objective of the follow-up study was to determine the regional recurrence-free rate (RRFR) after sentinel lymph node biopsy with Lymphoseek. Results of the follow-up study indicated that in patients who were confirmed to be node-negative after sentinel lymph node biopsy (n=88; 49 breast cancer, 39 melanoma) the RRFR was 98.8% (100% in breast cancer; 97.4% in melanoma) and the disease-specific survival rate was 98.6% (97.8% in breast cancer; 100% in melanoma) at three years.

In June 2014, the Company announced results from combined analyses of Phase 3 clinical trials that evaluated Lymphoseek efficacy in lymphatic mapping for identifying pathology-positive lymph nodes across multiple solid tumor types: melanoma, breast cancer and head and neck squamous cell carcinoma. The results indicated that Lymphoseek sensitivity for sentinel lymph node mapping was consistent across the tumor type studies, regardless of whether surgery was conducted on the same day as, or on the day after, injection of Lymphoseek. Additionally, for patients with head and neck cancer, Lymphoseek demonstrated a low false negative rate (FNR) of 2.6% (4.6% for same day injection before surgery and 0.0% FNR in patients injected the day prior to surgery). Results from the study comprise part of an sNDA filing for Lymphoseek which is under review by the FDA.

Also in June 2014, we announced results from a post-hoc analysis of patient data from the Company's Phase 3 clinical trial (NEO3-06) of Lymphoseek in head and neck cancer. In the NEO3-06 Phase 3 study, Lymphoseek localization to lymph nodes showed a strong correlation with a full regional lymph node dissection and pathology analysis with a low false negative rate, a priority in identifying sentinel nodes. Lymphoseek was also observed to home preferentially to pathology-positive nodes at a higher rate than pathology-negative nodes. These results suggest that Lymphoseek not only effectively targets sentinel lymph nodes, but further that its ability to highlight tumor-positive lymph nodes may be augmented mechanistically by the recruitment of macrophages to cancer-harboring lymph nodes.

An investigator-initiated study is currently underway at the University of California, San Diego (UCSD) to evaluate injection site pain between Lymphoseek and an alternative radiopharmaceutical that is commonly used in lymphatic mapping procedures. The study is designed to determine if patients receiving Lymphoseek experience the same or less pain following injection compared to radiolabeled sulfur colloid, and to measure the amount of discomfort that patients report during and after injection, as well as other characteristics of performance.

In July 2014, we amended our license agreement with UCSD for the exclusive world-wide rights to Lymphoseek. The amended license agreement is effective until the third anniversary of the expiration date of the longest-lived underlying patent. Under the terms of the license agreement, UCSD has granted us the exclusive rights to make, use, sell, offer for sale and import licensed products as defined in the agreement and to practice the defined licensed methods during the term of the agreement. We may also sublicense the patent rights, subject to certain sublicense terms as defined in the agreement. In consideration for the license rights, we agreed to make payments to UCSD upon successfully reaching certain clinical, regulatory and cumulative sales milestones, and a royalty on net sales of licensed products subject to a $25,000 minimum annual royalty. We also agreed to reimburse UCSD for all patent-related costs and to meet certain diligence targets.

We are currently pursuing registration of Lymphoseek in the European Union (EU). We submitted our Marketing Authorization Application (MAA) for Lymphoseek to the European Medicines Agency (EMA) in December 2012. In December 2013, the EMA provided updated feedback on the MAA as it continued its review. The updated feedback was limited to supplemental product specification data and the NEO3-06 Phase 3 study in head and neck cancer. In March 2014, we held an update meeting with the EMA where we presented oral explanations to the Committee for Medicinal Products for Human Use (CHMP) relating to open questions on the Lymphoseek MAA. At the conclusion of the meeting, the CHMP informed Navidea that the Committee will continue with its review of the MAA and provided the Company with additional questions, which we are currently addressing. In April 2014, the Company announced its expectation that the CHMP would convene a meeting of the Scientific Advisory Group on Oncology (SAG-O) to discuss additional elements of the Lymphoseek clinical study in patients with head and neck cancer to provide an opportunity for Navidea and independent experts in head and neck cancer surgery to review clinical data in the MAA filing and discuss broad aspects of care for patients with head and neck cancer in Europe. Navidea expects that the SAG-O's opinion, though not binding, will be considered by the CHMP when it meets to review the Lymphoseek MAA later this year. During this process, the MAA remains active and the review clock will continue to be stopped while Navidea works with the CHMP to continue expanded discussions. A positive opinion for approval would enable commercialization in the EU subsequent to European Commission (EC) adoption of the CHMP opinion on a country-by-country basis in each member state, a process which could take several months. However, we cannot assure you that Lymphoseek will achieve regulatory approval in the EU or any market outside the U.S., or if approved, that it will achieve market acceptance in any market.

Manocept Platform

Navidea’s Manocept platform is predicated on the ability to specifically target the CD206 mannose receptor expressed on macrophages. Macrophages play important roles in many disease states and are an emerging target in many diseases where diagnostic uncertainty exists. This flexible and versatile platform serves as an engine for purpose-built molecules that may enhance diagnostic accuracy, clinical decision-making and ultimately patient care, while offering the potential to utilize a breadth of diagnostic modalities, including SPECT, PET, intra-operative and/or optical-fluorescence detecdth:36pt;">

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acquire complementary businesses or technologies; or

· otherwise respond to competitive pressures.

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

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

As of April 30, 2016, our $2.8 million of long term investments recorded at fair value consisted entirely of auction rate municipal bonds with maturities that range from approximately 3 to 18 years. These investments have characteristics similar to short term investments, because at pre determined intervals, generally ranging from 30 to 35 days, there is a new auction process at which the interest rates for these securities are reset to current interest rates. At the end of such period, we choose to roll over our holdings or redeem the investments for cash. A market maker facilitates the redemption of the securities and the underlying issuers are not required to redeem the investment within 365 days.

Since fiscal 2008, we have experienced failed auctions of our auction rate securities and there is no assurance that auctions on the remaining auction rate securities in our investment portfolio will succeed in the future. As a result, our ability to liquidate our investments in the near term may be limited, and our ability to recover the carrying value of our investments may be limited. An auction failure means that the parties wishing to sell securities were not able to do so. As of June 17, 2016, including the securities involved in failed auctions, we held approximately $2.4 million of these auction rate securities, all of which carry investment grade ratings. These investments are subject to general credit, liquidity, market and interest rate risks, which may be exacerbated by problems in the global credit markets. These and other related factors have affected various sectors of the financial markets and caused credit and liquidity issues. If the issuers of these securities are unable to successfully close future auctions or their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. We currently believe these securities are not permanently impaired, primarily due to the government backing of the underlying securities. However, it could take until the final maturity of the underlying notes (up to 18 years) to realize our investments' purchase price of $2.7 million. Based on our ability to access our cash and cash equivalents, expected operating cash flows, and our other sources of cash, we do not anticipate that the current lack of liquidity on these investments will affect our ability to continue to operate our business in the ordinary course, however we can provide no assurance as to when these investments will again become liquid or as to whether we may ultimately have to recognize an impairment charge with respect to these investments.

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

Global credit and financial markets have experienced extreme disruptions in recent years, including severely diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates and uncertainty about economic stability. There can be no assurance that renewed deterioration in credit and financial markets and confidence in economic conditions will not occur. Our general business strategy may be adversely affected by any economic downturn, volatile business environment or continued unpredictable and unstable market conditions. If the current equity and credit markets deteriorate, or do not improve, it may make any necessary debt or equity financing more difficult, more costly and more dilutive. Failure to secure any necessary financing in a timely manner and on favorable terms could have a material adverse effect on our growth strategy, financial performance and stock price and could require us to delay or abandon implementing business initiatives. These events and the continuing market upheavals could adversely affect our business in a number of ways, including:

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

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

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

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

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

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

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

· diversion of financial and management resources from existing operations;

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

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

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

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

- inability to generate sufficient revenue to offset acquisition costs.

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

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

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

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

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

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

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

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

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

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

Risks Related to Our U.S. Government Contracts

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

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

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

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

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

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

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

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

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

- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

Also, we need special security clearances and regulatory approvals to continue working on certain of our projects with the U.S. government. Classified programs generally will require that we comply with various executive orders, federal laws and regulations and customer security requirements that may include restrictions on how we develop, store, protect and share information, and may require our employees and facilities to obtain government security clearances. Our failure to comply with applicable regulations, rules and approvals or misconduct by any of our employees could result in the imposition of fines and penalties, the loss of security clearances, the loss of our

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government contracts or our suspension or debarment from contracting with the U.S. government generally, any of which could harm our business, financial condition and results of operations. We are also subject to certain regulations of comparable government agencies in other countries, and our failure to comply with these non U.S. regulations could also harm our business, financial condition or results of operations.

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

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

Like most government contractors, our contracts are audited and reviewed on a continual basis by the DCMA and the DCAA. The indirect costs we incur in performing government contracts have been audited on an annual basis. The DCMA, disallowed a portion of the Company's executive compensation and other costs included in the Company's fiscal 2006, 2007 and 2008 incurred cost claims and sought interest for all three years and penalties for Fiscal 2006, based on the disallowed costs. The Company appealed these cost disallowances to the Armed Services Board of Contract Appeals. For Fiscal 2006, as a result of partial settlements and a decision of the Armed Services Board of Contract Appeals in March 2016, the government's remaining claims were dismissed with prejudice. All of the government's claims related to the Company's 2007 and 2008 incurred cost claims were settled as of October 2015 by payment to the government of $50,000 and the government's claims related to the Company's 2009 incurred cost claims were settled as of October 2015 without the payment of any consideration. Audits for costs incurred on work performed after fiscal year 2009 have not yet been completed. In addition, non audit reviews or investigations by the government may still be conducted on all of our government contracts.

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

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

If we were suspended or debarred from contracting with the federal government generally, or any specific agency, if our reputation or relationship with government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating results could be materially harmed. For example, in February 2010, we were notified by the DOJ that it had initiated a civil investigation into our cost charging practices with respect to government contracts. We resolved these claims with the DOJ in October 2013. Under the settlement agreement, we reimbursed the government for an amount erroneously charged to the government in our FY2006 incurred cost claim submittal.

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

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

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

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

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

In addition, U.S. government contracts generally contain provisions permitting termination, in whole or in part, at the government's convenience or for contractor default. Since a substantial majority of our revenue is dependent on the procurement, performance and payment under our U.S. government contracts, the termination of one or more critical government contracts could have a negative impact on our results of operations and financial condition. Termination arising out of our default could expose us to liability and have a material adverse effect on our ability to re compete for future contracts and orders. Moreover, several of our contracts with the U.S. government do not contain a limitation of liability provision, creating a risk of responsibility for indirect, incidental damages and consequential damages. These provisions could cause substantial liability for us, especially given the use to which our products may be put.

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

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

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

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

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

· the expense and delay that may arise if our competitors protest or challenge contract awards made to us pursuant to competitive bidding, and the risk that any such protest or challenge could result in the delay of

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our contract performance, the distraction of management, the resubmission of bids on modified specifications, or in termination, reduction or modification of the awarded contract.

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

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

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

Risks Related to Our Intellectual Property

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

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

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

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

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

Risks Relating to Securities Markets and Investment in Our Stock

The price of our common stock may fluctuate significantly.

The market prices for securities of emerging technology companies have historically been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. The market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot control, including the following:

- U.S. government spending levels, both generally and by our particular customers;

- the volume of operational activity by the U.S. military;

- delays in the payment of our invoices by government payment offices, resulting in potentially reduced earnings during a particular fiscal quarter;

· announcements of new products or technologies, commercial relationships or other events relating to us or our industry or our competitors;

· failure of any of our key products to gain market acceptance;

· variations in our quarterly operating results;

· perceptions of the prospects for the markets in which we compete;

· changes in general economic conditions;

· changes in securities analysts' estimates of our financial performance;

· regulatory developments in the United States and foreign countries;

· fluctuations in stock market prices and trading volumes of similar companies;

· news about the markets in which we compete or regarding our competitors;

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- terrorist acts or military action related to international conflicts, wars or otherwise;

- sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders; and

- additions or departures of key personnel.

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

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

As of June 17, 2016, our directors, executive officers and their affiliates collectively beneficially owned 3,009,991 shares, or approximately 13%, of our total outstanding shares of common stock. Accordingly, our directors and executive officers as a group may be able to exert significant influence over matters requiring stockholder approval, including the election of directors. The interests of our directors and executive officers may not be fully aligned with yours. Although there is no agreement among our directors and executive officers with respect to the voting of their shares, this concentration of ownership may delay, defer or even prevent a change in control of our company, and make transactions more difficult or impossible without the support of all or some of our directors and executive officers. These transactions might include proxy contests, tender offers, mergers or other purchases of common stock that could give you the opportunity to realize a premium over the then prevailing market price for shares of our common stock.

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

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

- The ability of our board of directors to issue preferred stock in one or more series of with such rights, obligations and preferences as the board may determine, without further vote or action by our stockholders;

- Advanced notice procedures for stockholders to nominate candidates for election to the board of directors and for stockholders to submit proposals for consideration at a meeting of stockholders;

- The absence of cumulative voting rights for our stockholders;

- The classification of our board of directors, which effectively prevents stockholders from electing a majority of the directors at any one annual meeting of stockholders;

- The limitation that directors may be removed only for cause by the affirmative vote of the holders of 66 2/3% of the total voting power of all of our outstanding securities entitled to vote in the election of directors, voting together as a single class; and

- Restrictions on the ability of our stockholders to call a special meeting of stockholders.

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

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

All of our facilities are leased. Our corporate headquarters are located in Monrovia, California where we lease approximately 36,000 square feet under an agreement expiring in June 2024. We have several other leased facilities in California, Alabama and Virginia that are used for administration, research and development, logistics and manufacturing and have a total of approximately 375,000 square feet. Such leases expire between the end of 2016 and 2021. We believe that our facilities are adequate to meet our needs for the foreseeable future.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosure.

Not applicable.

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PART II

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

Common Stock

The following table sets forth, for the periods indicated, the high and low sales prices for our common stock from May 1, 2014 through April 30, 2016. The following quotations reflect inter dealer prices, without retail mark up, mark down or commission, and may not represent actual transactions.

	Fiscal Year Ended April 30,			
	2016		2015	
	High	Low	High	Low
First Quarter	$ 29.22	$ 25.01	$ 36.50	$ 30.20
Second Quarter	$ 27.00	$ 19.10	$ 33.85	$ 27.20
Third Quarter	$ 30.65	$ 21.86	$ 30.87	$ 24.73
Fourth Quarter	$ 29.94	$ 23.13	$ 28.92	$ 25.00

On June 17, 2016, the closing sales price of our common stock as reported on the NASDAQ Global Select Market was $30.50 per share. As of June 17, 2016, there were 68 holders of record of our common stock.

Dividends

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

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Stock Price Performance Graph

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

The following table shows the value of $100 invested on April 30, 2011 in AeroVironment, Inc., the Russell 2000 Index and the SPADE Defense Index.

	Performance Graph Table ($)					
	April 30, 2011	April 30 2012	April 30, 2013	April 30, 2014	April 30 2015	April 30, 2016
AeroVironment Stock	100	85	68	118	89	101
Russell 2000 Index	100	94	109	130	141	131
SPADE Defense Index	100	97	114	158	176	180

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

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Issuer Purchases of Equity Securities

On September 24, 2015, we announced that on September 23, 2015 our Board of Directors authorized a share repurchase program (the "Share Repurchase Program"), pursuant to which we may repurchase up to $25 million of our common stock from time to time, in amounts and at prices we deem appropriate, subject to market conditions and other considerations. Share repurchases may be executed through open market transactions or negotiated purchases and may be made under a Rule 10b5-1 plan. There is no expiration date for the program. The Share Repurchase Program does not obligate us to acquire any particular amount of common stock and may be suspended at any time by our Board of Directors. We did not repurchase any shares during the fiscal quarter ended April 30, 2016. As of April 30, 2016, approximately $21.2 million remained authorized for future repurchases under this program.

Item 6. Selected Consolidated Financial Data.

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

	Year Ended April 30,				
	2016	2015	2014	2013	2012
	(In thousands, except per share data)				
Consolidated Income Statement Data:					
Revenue	$ 264,098	$ 259,398	$ 251,703	$ 240,152	$ 325,008
Net income	$ 8,966	$ 2,895	$ 13,718	$ 10,426	$ 30,451
Earnings per common share:					
Basic	$ 0.39	$ 0.13	$ 0.61	$ 0.47	$ 1.40
Diluted	$ 0.39	$ 0.13	$ 0.60	$ 0.47	$ 1.36
Weighted average common shares outstanding (basic):	22,936	22,869	22,354	22,070	21,783
Weighted average common shares outstanding (diluted):	23,153	23,146	22,719	22,390	22,315
Balance Sheet Data					
Total assets	$ 410,393	$ 397,467	$ 384,954	$ 361,604	$ 369,151
Capital lease obligations, current portion	$ 390	$ —	$ —	$ —	$ —
Capital lease obligations, net of current portion	$ 449	$ —	$ —	$ —	$ —
Long-term obligations	$ 2,339	$ 1,820	$ 4,752	$ 4,231	$ 6,854

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

Introduction

The following discussion of our financial condition and results of operations should be read in conjunction with our "Selected Consolidated Financial Data" and our consolidated financial statements and notes thereto included herein as Item 8. This discussion contains forward looking statements. Refer to "Forward Looking Statements" on page 2 and "Risk Factors" beginning on page 22, for a discussion of the uncertainties, risks and assumptions associated with these statements.

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Overview

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

The success we have achieved with our current products and services stems from our investment in research and development and our ability to invent and deliver advanced solutions, utilizing our proprietary technologies, to help our government, commercial and consumer customers operate more effectively and efficiently. We develop these highly innovative solutions by working very closely with our key customers in each segment of our business and solving their most important challenges related to our areas of expertise. Our core technological capabilities, developed through more than 40 years of innovation, include lightweight aerostructures, power electronics, electric propulsion systems, efficient electric power generation, conversion, and storage systems, high density energy packaging, miniaturization, DDL, aircraft payloads, controls integration, systems integration and engineering optimization coupled with professional field service capabilities.

Our UAS business 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 our customers' operations. Our Efficient Energy Systems, or EES, business 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.

Revenue

We generate our revenue primarily from the sale, support and operation of our small UAS, tactical missile systems, electric vehicle charging systems and power cycling and test systems solutions. Support for our small UAS customers includes training, spare parts, product repair, product replacement, and the customer contracted operation of our small UAS by our personnel. We refer to these support activities, in conjunction with customer funded R&D, as our services operation. We derive most of our small UAS revenue from fixed price and cost plus fee contracts with the U.S. government, and most of our electric vehicle charging systems and power cycling and test systems revenue from sales and service to commercial customers.

Cost of Sales

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

Gross Margin

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

Research and Development Expense

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

Selling, General and Administrative

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

Other Income and Expenses

Other income and expenses includes interest income, interest expense, amortization of capital lease payments, changes in fair value of certain financial investments, gains/losses on sale of available for sale equity securities and losses from equity method investments.

Income Tax Expense

Our effective tax rates are substantially lower than the statutory rates primarily due to research and development tax credits.

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.

We believe the following critical accounting estimates affect our more significant judgments and estimates used in preparing our consolidated financial statements. See Note 1 of the Notes to Consolidated Financial Statements for our Organization and Significant Accounting Policies. There have been no material changes made to the critical accounting estimates during the periods presented in the consolidated financial statements.

Revenue Recognition

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

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

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

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

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

We review cost performance and estimates to complete at least quarterly and in many cases more frequently. Adjustments to original estimates for a contract's revenue, estimated costs at completion and estimated profit or loss are often required as work progresses under a contract, as experience is gained and as more information is obtained, even though the scope of work required under the contract may not change, or if contract modifications occur. The impact of revisions in profit estimates for all types of contracts are recognized on a cumulative catch up basis in the period in which the revisions are made. During the fiscal years ended April 30, 2016, 2015 and 2014, changes in accounting estimates on fixed price contracts recognized using the percentage of completion method of accounting are presented below. Amounts representing contract change orders or claims are included in revenue only when they can be reliably estimated and their realization is probable. Incentives or penalties and awards applicable to performance on contracts are considered in estimating revenue and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance.

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For the years ended April 30, 2016, 2015 and 2014, favorable and unfavorable cumulative catch up adjustments included in cost of sales were as follows (in thousands):

	Year Ended April 30,		
	2016	2015	2014
Gross favorable adjustments	$ 479	$ 885	$ 699
Gross unfavorable adjustments	(210)	(1,017)	(337)
Net adjustments	$ 269	$ (132)	$ 362

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

For the year ended April 30, 2015, favorable cumulative catch up adjustments of $0.9 million were primarily due to final cost adjustments on 28 contracts, which individually were not material. For the same period, unfavorable cumulative catch up adjustments of $1.0 million were primarily related to higher than expected costs on 170 contracts, which individually were not material.

For the year ended April 30, 2014, favorable cumulative catch up adjustments of $0.7 million were primarily due to final cost adjustments on 274 contracts, which individually were not material. For the same period, unfavorable cumulative catch up adjustments of $0.3 million were primarily related to higher than expected costs on eight contracts, which individually were not material.

Inventories and Reserve for Excess and Obsolescence

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

Self Insured Liability

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

Impairment of Long Lived Assets

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

Long Term Incentive Awards

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

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

Income Taxes

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

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

Fiscal Periods

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

Results of Operations

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

	Fiscal Year Ended April 30,					
	2016		2015		2014	
Revenue	$ 264,098	100%	$ 259,398	100%	$ 251,703	100%
Cost of sales	151,995	58 %	155,130	60 %	158,090	63 %
Gross margin	112,103	42 %	104,268	40 %	93,613	37 %
Selling, general and administrative	60,077	23 %	55,763	21 %	55,679	22 %
Research and development	42,291	16 %	46,491	18 %	25,515	10 %
Income from operations	9,735	4 %	2,014	1 %	12,419	5 %
Interest income, net	1,032	— %	882	— %	855	— %
Other (expense) income, net	(2,699)	(1) %	(1,003)	— %	1,622	1 %
Income before income taxes	8,068	3 %	1,893	1 %	14,896	6 %
Income tax (benefit) expense	(898)	— %	(1,002)	— %	1,178	— %
Net income	$ 8,966	3 %	$ 2,895	1 %	$ 13,718	5 %

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The following table sets forth our revenue, costs of sales and gross margin generated by each operating segment for the periods indicated:

	Fiscal Year Ended April 30,		
	2016	2015	2014
	(In thousands)		
Revenue:			
UAS	$ 233,738	$ 220,950	$ 208,810
EES	30,360	38,448	42,893
Total	$ 264,098	$ 259,398	$ 251,703
Cost of sales:			
UAS	$ 132,209	$ 128,233	$ 127,992
EES	19,786	26,897	30,098
Total	$ 151,995	$ 155,130	$ 158,090
Gross margin:			
UAS	$ 101,529	$ 92,717	$ 80,818
EES	10,574	11,551	12,795
Total	$ 112,103	$ 104,268	$ 93,613

Fiscal Year Ended April 30, 2016 Compared to Fiscal Year Ended April 30, 2015

Revenue. Revenue for the fiscal year ended April 30, 2016 was $264.1 million, as compared to $259.4 million for the fiscal year ended April 30, 2015, representing an increase of $4.7 million, or 2%. The increase in revenue was due to an increase in service revenue of $20.3 million, partially offset by a decrease in product deliveries of $15.6 million. UAS revenue increased $12.8 million, or 6%, to $233.7 million for the fiscal year ended April 30, 2016, primarily due to an increase in customer funded R&D of $16.6 million and an increase in service revenue of $4.5 million, partially offset by a decrease in product deliveries of $8.3 million. The increase in customer funded R&D was primarily due to tactical missile system variant programs. The increase in service revenue was primarily due to an increase in sustainment activities in small UAS. The decrease in product deliveries was primarily due to a decrease in product deliveries of Wasp and Switchblade systems, partially offset by an increase in deliveries of Puma and Raven systems. EES revenue decreased $8.1 million, or 21%, to $30.4 million for the fiscal year ended April 30, 2016, primarily due to a decrease in product deliveries of our industrial fast charge systems and passenger electric vehicle charging systems as well as a decrease in service revenue.

Cost of Sales. Cost of sales for the fiscal year ended April 30, 2016 was $152.0 million, as compared to $155.1 million for the fiscal year ended April 30, 2015, representing a decrease of $3.1 million, or 2%. Cost of sales was impacted by a government contract accounting reserve reduction of $3.6 million recorded during the year ended April 30, 2016 for the settlement and resolution of prior year incurred cost audits. As a percentage of revenue, cost of sales decreased from 60% to 58%. The decrease in cost of sales was a result of a decrease in product cost of sales of $12.8 million, partially offset by an increase in service costs of sales of $9.7 million. UAS cost of sales increased $4.0 million to $132.2 million for the fiscal year ended April 30, 2016. As a percentage of revenue, cost of sales for

UAS decreased from 58% to 57%, primarily due to a favorable product mix and the government contract reserve reduction. EES cost of sales decreased $7.1 million, or 26%, to $19.8 million for the fiscal year ended April 30, 2016 primarily due to a decrease in sales volume and, to a lesser extent, the government contract reserve reduction. As a percentage of revenue, cost of sales for EES decreased from 70% to 65%, primarily due to a favorable product mix and the government contract reserve reduction.

Gross Margin. Gross margin for the fiscal year ended April 30, 2016 was $112.1 million, as compared to $104.3 million for the fiscal year ended April 30, 2015, representing an increase of $7.8 million, or 8%. The increase in gross margin was due to an increase in service margin of $10.5 million, partially offset by a decrease in product margin of $2.7 million, both of which were impacted by the government contract reserve reduction. The increase in service

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margin was primarily due to the increase in service revenue. The decrease in product margin was primarily due to the decrease in product deliveries, partially offset by a favorable product mix and the government contract reserve reduction. As a percentage of revenue, gross margin increased from 40% to 42%. UAS gross margin increased $8.8 million, or 10%, to $101.5 million for the fiscal year ended April 30, 2016, primarily due to the increase in services revenue as well as a favorable product mix and the government contract reserve reduction. As a percentage of revenue, gross margin for UAS increased from 42% to 43%. EES gross margin decreased $1.0 million, or 8%, to $10.6 million for the fiscal year ended April 30, 2016, primarily due to a decrease in sales volume, partially offset by the government contract reserve reduction. As a percentage of revenue, EES gross margin increased from 30% to 35%, primarily due to a favorable product mix and the government contract reserve reduction.

Selling, General and Administrative. SG&A expense for the fiscal year ended April 30, 2016 was $60.1 million, or 23% of revenue, compared to SG&A expense of $55.8 million, or 21% of revenue, for the fiscal year ended April 30, 2015. The increase in SG&A expense was primarily due to higher bid and proposal costs, an increase in sales commission expense as a result of our increased international revenues, and an increase in severance related charges as well as other increases which were not individually significant.

Research and Development. R&D expense for the fiscal year ended April 30, 2016 was $42.3 million, or 16% of revenue, compared to R&D expense of $46.5 million, or 18% of revenue, for the fiscal year ended April 30, 2015. R&D expense decreased primarily due to decreased development activities for certain strategic initiatives.

Interest Income, net. Interest income, net for the fiscal year ended April 30, 2016 was $1.0 million, compared to $0.9 million for the fiscal year ended April 30, 2015.

Other Expense, net. Other expense, net for the fiscal year ended April 30, 2016 was $2.7 million, as compared to other expense, net of $1.0 million for the fiscal year ended April 30, 2015. The increase is primarily due to the recording of an other-than-temporary impairment loss on our CybAero equity securities during the first quarter of fiscal 2016.

Income Taxes. Our effective income tax benefit rate was (11.1)% for the fiscal year ended April 30, 2016, as compared to an effective income tax benefit rate of (52.9)% for the fiscal year ended April 30, 2015. The variance in the effective income tax rates was primarily due to higher pre tax income and an increase in federal R&D tax credits primarily as a result of federal legislation reinstating the federal research and development tax credit.

Fiscal Year Ended April 30, 2015 Compared to Fiscal Year Ended April 30, 2014

Revenue. Revenue for the fiscal year ended April 30, 2015 was $259.4 million, as compared to $251.7 million for the fiscal year ended April 30, 2014, representing an increase of $7.7 million, or 3%. The increase in revenue was due to an increase in product deliveries of $10.0 million offset by a decrease in service revenue of $2.3 million. UAS revenue increased $12.1 million, or 6%, to $221.0 million for the fiscal year ended April 30, 2015, primarily due to increased product deliveries of $12.2 million and an increase in customer funded R&D of $8.6 million, offset by a decrease in service revenue of $8.6 million. The increase in product deliveries was primarily due to increased product deliveries of Wasp systems. The increase in customer funded R&D was primarily due to phase two of the Tern program and a Switchblade variant program. The decrease in service revenue was primarily due to decreased repair activities in small UAS and Switchblade services. EES revenue decreased $4.4 million, or 10%, to $38.4 million for the fiscal year ended April 30, 2015, primarily due to decreased product deliveries of our industrial fast charge systems and passenger electric vehicle charging systems.

Cost of Sales. Cost of sales for the fiscal year ended April 30, 2015 was $155.1 million, as compared to $158.1 million for the fiscal year ended April 30, 2014, representing a decrease of $3.0 million, or 2%. As a percentage of revenue, cost of sales decreased from 63% to 60%. The decrease in cost of sales was a result of a decrease in product cost of sales of $0.3 million and service costs of sales of $2.7 million. UAS cost of sales increased $0.2 million to $128.2 million for the fiscal year ended April 30, 2015. As a percentage of revenue, cost of sales for UAS decreased from 61% to 58%, primarily due to a favorable product mix. EES cost of sales decreased $3.2 million, or 11%, to

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$26.9 million for the fiscal year ended April 30, 2015 due to a decrease in sales volume. As a percentage of revenue, cost of sales for EES remained at 70%.

Gross Margin. Gross margin for the fiscal year ended April 30, 2015 was $104.3 million, as compared to $93.6 million for the fiscal year ended April 30, 2014, representing an increase of $10.7 million, or 11%. The increase in gross margin was due to an increase in product margin of $10.4 million and service margin of $0.3 million. The increase in product margin was primarily due to an increase in product deliveries. As a percentage of revenue, gross margin increased from 37% to 40%. UAS gross margin increased $11.9 million, or 15%, to $92.7 million for the fiscal year ended April 30, 2015, primarily due to a favorable product mix. As a percentage of revenue, gross margin for UAS increased from 39% to 42%. EES gross margin decreased $1.2 million, or 10%, to $11.6 million for the fiscal year ended April 30, 2015, primarily due to a decrease in sales volume. As a percentage of revenue, EES gross margin remained at 30%.

Selling, General and Administrative. SG&A expense for the fiscal year ended April 30, 2015 was $55.8 million, or 21% of revenue, compared to SG&A expense of $55.7 million, or 22% of revenue, for the fiscal year ended April 30, 2014.

Research and Development. R&D expense for the fiscal year ended April 30, 2015 was $46.5 million, or 18% of revenue, compared to R&D expense of $25.5 million, or 10% of revenue, for the fiscal year ended April 30, 2014. R&D expense increased primarily due to increased development activities for certain strategic initiatives.

Interest Income. Interest income for the fiscal years ended April 30, 2015 and 2014 was $0.9 million.

Other Expense. Other expense for the fiscal year ended April 30, 2015 was $1.0 million, as compared to other income of $1.6 million for the fiscal year ended April 30, 2014. The decrease is primarily due to a reduction in the fair value of the conversion feature of our investment in convertible bonds and related sales of equity securities.

Income Taxes. Our effective income tax rate was (52.9)% for the fiscal year ended April 30, 2015, as compared to an effective income tax rate of 7.9% for the fiscal year ended April 30, 2014. The variance in the effective income tax rate was primarily due to lower pre tax income and federal R&D tax credits.

Liquidity and Capital Resources

We currently have no material cash commitments, except for normal recurring trade payables, accrued expenses and ongoing research and development costs, all of which we anticipate funding through our existing working capital and funds provided by operating activities. The majority of our purchase obligations are pursuant to funded contractual arrangements with our customers. We believe that our existing cash, cash equivalents, cash provided by operating activities and other financing sources will be sufficient to meet our anticipated working capital, capital expenditure and debt service requirements, if any, during the next twelve months. There can be no assurance, however, that our business will continue to generate cash flow at current levels. If we are unable to generate sufficient cash flow from operations, then we may be required to sell assets, reduce capital expenditures or obtain additional financing. We anticipate that existing sources of liquidity and cash flows from operations will be sufficient to satisfy our cash needs for the foreseeable future.

Our primary liquidity needs are for financing working capital, investing in capital expenditures, supporting product development efforts, introducing new products and enhancing existing products, and marketing acceptance and adoption of our products and services. Our future capital requirements, to a certain extent, are also subject to general conditions in or affecting the defense 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. In addition, we may also need to seek additional equity funding or debt financing if we become a party to any agreement or letter of intent for potential investments in, or acquisitions of, businesses, services or technologies.

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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 as of:

	Fiscal Year Ended April 30,		
	2016	2015	2014
	(In thousands)		
Net cash provided by operating activities	$ 551	$ 39,413	$ 34,005
Net cash (used in) provided by investing activities	$ (16,578)	$ (23,820)	$ 10,438
Net cash (used in) provided by financing activities	$ (3,096)	$ 848	$ 7,194

Cash Provided by Operating Activities. Net cash provided by operating activities for the fiscal year ended April 30, 2016 decreased by $38.8 million to $0.6 million, compared to net cash provided by operating activities of $39.4 million for the fiscal year ended April 30, 2015. This decrease in net cash provided by operating activities was primarily due to an increase in the use of cash as a result of changes in operating assets and liabilities of $40.9 million largely resulting from increases in accounts receivable due to the year over year timing of revenue, a decrease in the net loss on disposal of fixed assets of $3.7 million and a decrease in depreciation expense of $2.3 million, partially offset by an increase in net income of $6.1 million and a non-cash other than temporary impairment charge on the CybAero available-for-sale equity securities of $2.2 million.

Net cash provided by operating activities for the fiscal year ended April 30, 2015 increased by $5.4 million to $39.4 million, compared to net cash provided by operating activities of $34.0 million for the fiscal year ended April 30, 2014. This increase in net cash provided by operating activities was primarily due to an increase in cash provided as a result of changes in operating assets and liabilities of $16.1 million, a higher loss on disposal of fixed assets of $3.7 million and a change in fair value of the CybAero notes of $1.7 million, partially offset by lower net income of $10.8 million, lower impairment of long lived assets of $2.9 million, lower tax benefits of $2.3 million and lower depreciation expense of $0.8 million.

Cash (Used in) Provided by Investing Activities. Net cash used in investing activities decreased by $7.2 million to $16.6 million for the fiscal year ended April 30, 2016, compared to net cash used in investing activities of

$23.8 million for the fiscal year ended April 30, 2015. The decrease in net cash used in investing activities was primarily due to lower net purchases of held to maturity investments of $17.6 million, partially offset by a decrease in sales of available for sale investments of $9.1 million and an increase in capital expenditures of $1.6 million. During the fiscal years ended April 30, 2016, 2015 and 2014, we used cash to purchase property and equipment totaling $6.8 million, $5.3 million and $7.1 million, respectively.

Net cash used in investing activities increased by $34.3 million to $23.8 million for the fiscal year ended April 30, 2015, compared to net cash provided by investing activities of $10.4 million for the fiscal year ended April 30, 2014. The increase in net cash used in investing activities was primarily due to higher net purchases of held to maturity investments of $46.2 million, partially offset by higher sales of available for sale investments of $9.7 million and lower capital expenditures of $1.9 million. During the fiscal years ended April 30, 2015, 2014 and 2013, we used cash to purchase property and equipment totaling $5.3 million, $7.1 million and $11.8 million, respectively.

Cash (Used in) Provided by Financing Activities. Net cash used in financing activities increased by $3.9 million to $3.1 million for the fiscal year ended April 30, 2016, compared to net cash provided by financing activities of $0.8 million for the fiscal year ended April 30, 2015. The increase was primarily due to the purchase and retirement of common stock of $3.8 million during the fiscal year ended April 30, 2016.

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Net cash provided by financing activities decreased by $6.3 million to $0.8 million for the fiscal year ended April 30, 2015, compared to net cash provided by financing activities of $7.2 million for the fiscal year ended April 30, 2014. The decrease was primarily due to lower exercises of stock options of $6.0 million.

Contractual Obligations

The following table describes our commitments to settle contractual obligations as of April 30, 2016:

	Payments Due By Period				
	Total	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years
	(In thousands)				
Operating lease obligations	$ 19,905	$ 4,347	$ 6,462	$ 4,860	$ 4,236
Capital lease obligations	896	424	472	—	—
Purchase obligations(1)	21,753	21,753	—	—	—
Total	$ 42,554	$ 26,524	$ 6,934	$ 4,860	$ 4,236

(1) Consists of all cancelable and non cancelable purchase orders as of April 30, 2016.

Off Balance Sheet Arrangements

As of April 30, 2016, we had no off balance sheet arrangements as defined in Item 303(a)(4) of the SEC’s Regulation S K.

Inflation

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

New Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014 09, Revenue from Contracts with Customers (Topic 606). The new revenue recognition standard provides a five step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU is effective for annual periods beginning after December 15, 2017 and shall be applied either retrospectively to each period presented or as a cumulative effect adjustment as of the date of adoption. We are evaluating the potential impact of this adoption on our consolidated financial statements.

In 2016, the FASB issued ASUs containing implementation guidance related to ASU 2014-09, including: ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations; ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which is intended to clarify two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance; and ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which contains certain provision and practical expedients in response to identified implementation issues. We are evaluating the potential impact of this adoption on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015 05, Intangibles—Goodwill and Other—Internal Use Software (Subtopic 350 40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement. This ASU adds explicit

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guidance into U.S. GAAP regarding a customer's accounting for fees paid in a cloud computing arrangement. The ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. A reporting entity should apply the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. We are evaluating the potential impact of this adoption on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This ASU does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. This ASU eliminates from U.S. GAAP the requirement to measure inventory at the lower of cost or market. Market under the previous requirement could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. Entities within the scope of this update will now be required to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory using LIFO or the retail inventory method. The amendments in this update are effective for fiscal years beginning after December 15, 2016, with early adoption permitted. We are evaluating the potential impact of this adoption on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes. This update simplifies the presentation of deferred income taxes, by requiring that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this update. This update is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. We are evaluating the potential impact of adoption on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This ASU requires the lessee to recognize the assets and liabilities for the rights and obligations created by leases with terms of 12 months or more. The guidance is effective for fiscal years beginning after December 15, 2018 and interim periods therein, with early adoption permitted. We are evaluating the potential impact of this adoption on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, accounting for forfeitures, and classification on the statement of cash flows. ASU 2016-09 will be effective for interim and annual reporting periods beginning after December 15, 2016. Early application is permitted. We are evaluating the impact of this adoption on our consolidated financial statements.

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

Interest Rate Risk

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

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Foreign Currency Exchange Rate Risk

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

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Item 8. Financial Statements and Supplementary Data.

AeroVironment, Inc.

Audited Consolidated Financial Statements

Index to Consolidated Financial Statements and Supplementary Data

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of AeroVironment, Inc. and subsidiaries as of April 30, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended April 30, 2016. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of AeroVironment, Inc. and subsidiaries at April 30, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended April 30, 2016, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth herein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), AeroVironment, Inc. and subsidiaries' internal control over financial reporting as of April 30, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated June 28, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California

June 28, 2016

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AEROVIRONMENT, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands except share data)

	April 30, 2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$ 124,287	$ 143,410
Short-term investments	103,404	85,381
Accounts receivable, net of allowance for doubtful accounts of $262 at April 30, 2016 and $606 at April 30, 2015	56,045	33,607
Unbilled receivables and retentions	18,899	17,356
Inventories, net	37,486	39,414
Deferred income taxes	5,432	5,265
Prepaid expenses and other current assets	4,150	4,599
Total current assets	349,703	329,032
Long-term investments	33,859	46,769
Property and equipment, net	16,762	13,499
Deferred income taxes	9,319	7,426
Other assets	750	741
Total assets	$ 410,393	$ 397,467
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$ 17,712	$ 19,243
Wages and related accruals	13,973	13,395
Income taxes payable	943	692
Customer advances	2,544	4,235
Other current liabilities	11,173	9,170
Total current liabilities	46,345	46,735
Deferred rent	1,714	1,381
Capital lease obligations - net of current portion	449	—
Other non-current liabilities	184	—
Liability for uncertain tax positions	441	439
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—23,359,925 shares at April 30, 2016 and 23,314,640 at April 30, 2015	2	2
Additional paid-in capital	154,274	148,293
Accumulated other comprehensive loss	(201)	(1,358)
Retained earnings	207,185	201,975
Total stockholders’ equity	361,260	348,912
Total liabilities and stockholders’ equity	$ 410,393	$ 397,467

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands except share and per share data)

	Year Ended April 30, 2016	2015	2014
Revenue:			
Product sales	$ 189,476	$ 205,027	$ 194,996
Contract services	74,622	54,371	56,707
	264,098	259,398	251,703
Cost of sales:			
Product sales	105,987	118,834	119,137
Contract services	46,008	36,296	38,953
	151,995	155,130	158,090
Gross margin:			
Product sales	83,489	86,193	75,859
Contract services	28,614	18,075	17,754
	112,103	104,268	93,613
Selling, general and administrative	60,077	55,763	55,679
Research and development	42,291	46,491	25,515
Income from operations	9,735	2,014	12,419
Other income (expense):			
Interest income, net	1,032	882	855
Other (expense) income, net	(2,699)	(1,003)	1,622
Income before income taxes	8,068	1,893	14,896
(Benefit) provision for income taxes	(898)	(1,002)	1,178
Net income	$ 8,966	$ 2,895	$ 13,718
Earnings per share data:			
Basic	$ 0.39	$ 0.13	$ 0.61
Diluted	$ 0.39	$ 0.13	$ 0.60
Weighted average shares outstanding:			
Basic	22,936,413	22,868,733	22,354,444
Diluted	23,153,493	23,145,997	22,719,218

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Year Ended April 30,		
	2016	2015	2014
Net income	$ 8,966	$ 2,895	$ 13,718
Other comprehensive income (loss):			
Unrealized gain (loss) on investments, net of tax expense (benefit) of $18, $(730) and $295 for the fiscal years ended April 30, 2016, April 30, 2015 and April 30, 2014, respectively	27	(1,095)	442
Total comprehensive income	$ 8,993	$ 1,800	$ 14,160

See accompanying notes to consolidated financial statements.

AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands except share data)

	Common Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive	
	Shares	Amount	Capital	Earnings	Loss	Total
Balance at April 30, 2013	22,614,315	$ 2	$ 130,527	$ 185,362	$ (705)	$ 315,186
Net income	—	—	—	13,718	—	13,718
Unrealized loss on investments	—	—	—	—	442	442
Stock options exercised	460,231	—	6,709	—	—	6,709
Restricted stock awards	128,500	—	—	—	—	—
Restricted stock awards forfeited	(35,869)	—	—	—	—	—
Restricted stock units vested	14,251	—	—	—	—	—
Tax withholding payment related to net share settlement of equity awards	(4,852)	—	(163)	—	—	(163)
Reclassification from share-based liability compensation to equity	—	—	—	—	—	—
Tax benefit from stock-based compensation	—	—	2,953	—	—	2,953
Stock-based compensation	—	—	3,622	—	—	3,622
Balance at April 30, 2014	23,176,576	2	143,648	199,080	(263)	342,467
Net income	—	—	—	2,895	—	2,895
Unrealized loss on investments	—	—	—	—	(1,095)	(1,095)
Stock options exercised	35,018	—	722	—	—	722
Restricted stock awards	160,180	—	—	—	—	—
Restricted stock awards forfeited	(56,004)	—	—	—	—	—
Restricted stock units vested	—	—	—	—	—	—
Tax withholding payment related to net share settlement of equity awards	(1,130)	—	(36)	—	—	(36)
Tax benefit from stock-based compensation	—	—	191	—	—	191
Stock-based compensation	—	—	3,768	—	—	3,768
Balance at April 30, 2015	23,314,640	2	148,293	201,975	(1,358)	348,912
Net income	—	—	—	8,966	—	8,966
	—	—	—	—	27	27

Unrealized gain on investments						
Reclassifications out of accumulated other comprehensive loss	—	—	—	—	1,130	1,130
Stock options exercised	84,881	—	1,122	—	—	1,122
Restricted stock awards	191,548	—	—	—	—	—
Restricted stock awards forfeited	(46,753)	—	—	—	—	—
Tax withholding payment related to net share settlement of equity awards	(1,130)	—	(29)	—	—	(29)
Reclassification from share-based liability compensation to equity	—	—	228	—	—	228
Tax benefit from stock-based compensation	—	—	98	—	—	98
Purchases of common stock for retirement	(183,261)	—	—	(3,756)	—	(3,756)
Stock based compensation	—	—	4,562	—	—	4,562
Balance at April 30, 2016	23,359,925	$ 2	$ 154,274	$ 207,185	$ (201)	$ 361,260

See accompanying notes to consolidated financial statements.

AEROVIRONMENT, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended April 30,		
	2016	2015	2014
Operating activities			
Net income	$ 8,966	$ 2,895	$ 13,718
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	6,074	8,366	9,155
Loss from equity method investments	138	240	30
Impairment of available-for-sale securities	2,186	—	—
Impairment of long-lived assets	—	438	3,317
Provision for doubtful accounts	(178)	(106)	(6)
Losses on foreign currency transactions	63	580	21
Loss (gain) on sale of equity securities	219	209	(4)
Deferred income taxes	(2,912)	(3,382)	(3,110)
Change in fair value of conversion feature of convertible bonds	—	(73)	(1,773)
Stock-based compensation	4,562	3,768	3,622
Tax benefit from exercise of stock options	161	52	2,305
Excess tax benefit from stock-based compensation	(39)	(162)	(648)
(Gain) loss on disposition of property and equipment	(22)	3,661	—
Amortization of held-to-maturity investments	3,875	4,532	5,037
Changes in operating assets and liabilities:			
Accounts receivable	(22,260)	(1,762)	(11,963)
Unbilled receivables and retentions	(1,543)	(6,427)	375
Inventories	1,928	11,285	11,862
Income tax receivable	—	6,584	5,193
Prepaid expenses and other assets	517	(339)	157
Accounts payable	(2,705)	5,337	(2,238)
Other liabilities	1,521	3,717	(1,045)
Net cash provided by operating activities	551	39,413	34,005
Investing activities			
Acquisition of property and equipment	(6,829)	(5,279)	(7,143)
Equity method investment	(295)	(395)	(105)
Redemptions of held-to-maturity investments	84,433	69,387	75,022
Purchases of held-to-maturity investments	(94,954)	(97,464)	(56,946)
Acquisition of intangible assets	—	(150)	(750)
Proceeds from the sale of property and equipment	80	—	—
Sales of available-for-sale investments	987	10,081	360
Net cash (used in) provided by investing activities	(16,578)	(23,820)	10,438
Financing activities			

Excess tax benefit from stock-based compensation	39	162	648
Principal payments of capital lease obligations	(472)	—	—
Purchase and retirement of common stock	(3,756)	—	—
Tax withholding payment related to net settlement of equity awards	(29)	(36)	(163)
Exercise of stock options	1,122	722	6,709
Net cash (used in) provided by financing activities	(3,096)	848	7,194
Net (decrease) increase in cash and cash equivalents	(19,123)	16,441	51,637
Cash and cash equivalents at beginning of year	143,410	126,969	75,332
Cash and cash equivalents at end of year	$ 124,287	$ 143,410	$ 126,969

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Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Income taxes	$ 1,576	$ 700	$ 2,556
Non-cash activities			
Unrealized change in fair value of long-term investments recorded in accumulated other comprehensive income (loss), net of tax expense (benefit) of $18, $(730) and $295 for the fiscal years ended April 30, 2016, April 30, 2015 and April 30, 2014, respectively	$ 27	$ (1,095)	$ 442
Reclassification from share-based liability compensation to equity	$ 228	$ —	$ —
Forfeiture of vested stock-based compensation	$ 86	$ 23	$ —
Acquisitions of property and equipment financed with capital lease obligations	$ 932	$ —	$ —
Acquisitions of property and equipment included in accounts payable	$ 1,174	$ —	$ —
Accrued acquisition of intangible assets	$ —	$ 250	$ —

See accompanying notes to consolidated financial statements.

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AEROVIRONMENT, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Significant Accounting Policies

Organization

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

Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of AeroVironment, Inc. and its wholly owned subsidiaries: AV S.r.l. Italy, Skytower, LLC, AeroVironment GmbH, AeroVironment Massachusetts, LLC, AeroVironment Rhode Island, LLC, Skytower Inc., AILC, Inc., AeroVironment International PTE. LTD. and Regenerative Fuel Cell Systems, LLC, Charger Bicycles, LLC and AeroVironment, Inc. (Afghanistan) (collectively referred to herein as the "Company"). All intercompany balances and transactions have been eliminated in consolidation.

In April 2016, the Company dissolved AV S.r.l. Italy, AILC, Inc. and AeroVironment Massachusetts, LLC the results of which were not material to the consolidated financial statements.

Investments in Companies Accounted for Using the Equity or Cost Method

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

When an investment accounted for using the equity method issues its own shares, the subsequent reduction in the Company's proportionate interest in the investee is reflected in equity as an adjustment to paid in capital. The Company evaluates its investments in companies accounted for by the equity or cost method for impairment when there is evidence or indicators that a decrease in value may be other than temporary.

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 about which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker ("CODM") in deciding how to allocate resources and in assessing performance. The Company's CODM 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 assessing performance. The Company's reportable segments are business units that offer different products and services and are managed separately.

Use of Estimates

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

Out-of-Period Adjustments

During the fiscal year ended April 30, 2016, the Company identified the following errors: 1) other current liabilities and the related cost of sales, selling, general and administrative and research and development expenses were understated due to state use taxes owed for certain internally consumed tangible assets not identified on a timely basis; and 2) property and equipment, net, were understated, capital lease obligations were understated, operating cash flows were understated, and investing cash flows were overstated due to certain IT equipment and perpetual software license capital lease agreements being incorrectly classified as operating leases. The Company assessed the materiality of these errors considering the relevant quantitative and qualitative factors and concluded that the errors were not material to the consolidated financial statements taken as a whole. As such, during the three months ended January 30, 2016, the Company recorded the following out-of-period adjustments to correct the errors: 1) increased "other current liabilities" $747,000, increased "research and development" expense $503,000, increased "selling, general and administrative" expense $155,000, and increased cost of sales $89,000; and 2) increased "property and equipment, net", $584,000, increased "Capital lease obligations – net of current portion" $319,000, and increased capital lease obligations – current portion $324,000 which is included in "Other current liabilities". In addition, $220,000 of cash outflows were reclassified from operating activities to "Principal payments on capital lease agreements" within financing activities. The consolidated statements of operations and consolidated statements of comprehensive income (loss) for the fiscal year ended April 30, 2016, the consolidated balance sheet as of April 30, 2016 and the consolidated statement of cash flows for the fiscal year ended April 30, 2016 reflect the above adjustments.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Cash Equivalents

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

Investments

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

Unrealized gains and losses are excluded from earnings and reported as a separate component of stockholders' equity, net of deferred income taxes for available-for-sale investments. The convertible bond in which the Company had invested, which was classified as available-for-sale, contained an embedded conversion feature which was bifurcated from the bond. The change in the fair value of the embedded conversion feature was recorded in other income in the income statement.

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

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

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

Fair Values of Financial Instruments

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

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash, cash equivalents, municipal bonds, U.S. government securities and accounts receivable. The Company currently invests the majority of its cash in municipal bonds and U.S. government securities. The Company’s revenue and accounts receivable are with a limited number of corporations and governmental entities. In the aggregate, 71%, 80% and 75% of the Company’s revenue came from agencies of the U.S. government for the years ended April 30, 2016, 2015 and 2014, respectively. These agencies accounted for 39% and 29% of the accounts receivable balances at April 30, 2016 and 2015, respectively. One such agency, the U.S. Army, accounted for 27%, 47% and 45% of the Company’s consolidated revenue for the years ended April 30, 2016, 2015 and 2014, respectively. The U.S. Army accounted for approximately 31%, 55% and 54% of UAS reportable segment sales for the years ended April 30, 2016, 2015 and 2014, respectively. The Company performs ongoing credit evaluations of its commercial customers and maintains an allowance for potential losses.

Accounts Receivable, Unbilled Receivables and Retentions

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

Retentions represent amounts withheld by customers until contract completion. At April 30, 2016 and 2015, the retention balances were $1,453,000 and $1,344,000, respectively. The Company determines the allowance for doubtful accounts based on historical customer experience and other currently available evidence. When a specific account is deemed uncollectible, the account is written off against the allowance. The allowance for doubtful accounts reflects the Company’s best estimate of probable losses inherent in the accounts receivable balance; such losses have historically been within management’s expectations. An account is deemed past due based on contractual terms rather than on how recently payments have been received.

Inventories

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

Long Lived Assets

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

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

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

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

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

Product Warranty

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

Accrued Sales Commissions

As of April 30, 2016 and 2015, the Company accrued sales commissions in other current liabilities of $3,287,000 and $837,000, respectively.

Self Insurance Liability

The Company is self insured for employee medical claims, subject to individual and aggregate stop loss policies. The Company estimates a liability for claims filed and incurred but not reported based upon recent claims experience and an analysis of the average period of time between the occurrence of a claim and the time it is reported to and paid by the Company. As of April 30, 2016 and 2015, the Company estimated and recorded a self insurance liability in wages and related accruals of approximately $1,176,000 and $1,293,000, respectively.

Income Taxes

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and income tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. The provision

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

Customer Advances and Amounts in Excess of Cost Incurred

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

Revenue Recognition

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

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

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

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

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

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

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

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

Stock Based Compensation

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

Long Term Incentive Awards

For long term incentive awards, a target payout is established at the beginning of each performance period. The actual payout at the end of the performance period is calculated based upon the Company's achievement of such targets. Payouts are made in cash and restricted stock units. Upon vesting of the restricted stock units, the Company has the discretion to settle the restricted stock units in cash or stock.

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

Research and Development

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

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

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$53,546,000, $36,998,000 and $28,393,000 for the years ended April 30, 2016, 2015 and 2014, respectively. The related cost of sales for customer funded research and development totaled approximately $34,786,000, $24,776,000 and $18,644,000 for the years ended April 30, 2016, 2015 and 2014, respectively.

Lease Accounting

The Company accounts for its leases and subsequent amendments as operating leases or capital leases for financial reporting purposes. Certain operating leases contain rent escalation clauses, which are recorded on a straight line basis over the initial term of the lease with the difference between the rent paid and the straight line rent recorded as a deferred rent liability. Lease incentives received from landlords are recorded as deferred rent liabilities and are amortized on a straight line basis over the lease term as a reduction to rent expense. Deferred rent liabilities were approximately $1,714,000 and $1,381,000 as of April 30, 2016 and 2015, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses included in SG&A expenses were approximately $486,000, $416,000 and $225,000 for the years ended April 30, 2016, 2015 and 2014, respectively.

Earnings Per Share

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

The reconciliation of diluted to basic shares is as follows:

	Year Ended April 30,		
	2016	2015	2014
Numerator for basic earnings per share:			
Net income	$ 8,966,000	$ 2,895,000	$ 13,718,000
Denominator for basic earnings per share:			
Weighted average common shares	22,936,413	22,868,733	22,354,444

Dilutive effect of employee stock options, restricted stock and restricted stock units	217,080	277,264	364,774
Denominator for diluted earnings per share	23,153,493	23,145,997	22,719,218

During the years ended April 30, 2016, 2015 and 2014, certain options, shares of restricted stock and restricted stock units were not included in the computation of diluted earnings per share because their inclusion would have been anti dilutive. The number of options, restricted stock and restricted stock units which met this anti dilutive criterion was approximately 22,000, 43,000 and 51,000 for the years ended April 30, 2016, 2015 and 2014, respectively.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014 09, Revenue from Contracts with Customers (Topic 606). The new revenue recognition standard provides a five step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU is effective for annual periods beginning after December 15, 2017 and shall be applied either retrospectively to each period presented or as a cumulative effect adjustment as of the date of adoption. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

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In 2016, the FASB issued ASUs containing implementation guidance related to ASU 2014-09, including: ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations; ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which is intended to clarify two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance; and ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which contains certain provision and practical expedients in response to identified implementation issues. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015 05, Intangibles—Goodwill and Other—Internal Use Software (Subtopic 350 40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. This ASU adds explicit guidance into U.S. GAAP regarding a customer's accounting for fees paid in a cloud computing arrangement. The ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. A reporting entity should apply the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This ASU does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. This ASU eliminates from U.S. GAAP the requirement to measure inventory at the lower of cost or market. Market under the previous requirement could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. Entities within the scope of this update will now be required to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory using LIFO or the retail inventory method. The amendments in this update are effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes. This update simplifies the presentation of deferred income taxes, by requiring that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this update. This update is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company is evaluating the potential impact of adoption on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This ASU requires the lessee to recognize the assets and liabilities for the rights and obligations created by leases with terms of 12 months or more. The guidance is effective for fiscal years beginning after December 15, 2018 and interim periods therein, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, accounting for forfeitures, and classification on the statement of cash flows. ASU 2016-09 will be effective for interim and annual reporting periods beginning after December 15, 2016. Early application is permitted. The Company is evaluating the potential impact of adoption on its consolidated financial statements.

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2. Investments

Investments consist of the following:

	April 30, 2016	2015
	(In thousands)	
Short-term investments:		
Held-to-maturity securities:		
Municipal securities	$ 42,179	$ 67,173
U.S. government securities	21,184	11,536
Corporate bonds	40,041	1,314
Certificates of deposit	—	3,885
Total held-to-maturity investments	$ 103,404	$ 83,908
Available for sale securities:		
Equity securities	—	1,473
Total available for sale investments	—	1,473
Total short-term investments	$ 103,404	$ 85,381
Long-term investments:		
Held-to-maturity securities:		
Municipal securities	$ —	$ 30,418
U.S. government securities	7,518	5,009
Corporate bonds	23,561	8,501
Certificates of deposit	—	—
Total held-to-maturity investments	31,079	43,928
Available-for-sale securities:		
Auction rate securities	2,780	2,841
Convertible bonds	—	—
Equity securities	—	—
Total available-for-sale investments	2,780	2,841
Total long-term investments	$ 33,859	$ 46,769

Held To Maturity Securities

As of April 30, 2016 and 2015, the balance of held to maturity securities consisted of state and local government municipal securities, U.S. government securities, corporate bonds and certificates of deposit. Interest earned from these investments is recorded in interest income.

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

	2016				2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal securities	$ 42,179	$ 5	$ (7)	$ 42,177	$ 97,591	$ 8	$ (35)	$ 97,564
U.S. government securities	28,702	23	—	28,725	16,545	12	—	16,557
Corporate bonds	63,602	54	(32)	63,624	9,815	—	(13)	9,802
Certificates of deposit	—	—	—	—	3,885	—	—	3,885
Total held to maturity investments	$ 134,483	$ 82	$ (39)	$ 134,526	$ 127,836	$ 20	$ (48)	$ 127,808

The amortized cost and fair value of the Company's held to maturity securities by contractual maturity at April 30, 2016, are as follows:

	Cost	Fair Value
Due within one year	$ 103,404	$ 103,415
Due after one year through five years	31,079	31,111
Total	$ 134,483	$ 134,526

Available For Sale Securities

Auction Rate Securities

As of April 30, 2016 and 2015, the entire balance of available for sale auction rate securities consisted of two investment grade auction rate municipal bonds with maturities ranging from 3 to 18 years. These investments have characteristics similar to short term investments, because at pre determined intervals, generally ranging from 30 to 35 days, there is a new auction process at which the interest rates for these securities are reset to current interest rates. At the end of such period, the Company chooses to roll over its holdings or redeem the investments for cash. A market maker facilitates the redemption of the securities and the underlying issuers are not required to redeem the investment within 365 days. Interest earned from these investments is recorded in interest income.

During the fourth quarter of the fiscal year ended April 30, 2008, the Company began experiencing failed auctions on some of its auction rate securities. A failed auction occurs when a buyer for the securities cannot be obtained and the market maker does not buy the security for its own account. The Company continues to earn interest on the investments that failed to settle at auction, at the maximum contractual rate until the next auction occurs. In the event the Company needs to access funds invested in these auction rate securities, the Company may not be able to liquidate these securities at the fair value recorded on April 30, 2016 until a future auction of these securities is successful or a buyer is found outside of the auction process.

As a result of the failed auctions, the fair values of these securities are estimated utilizing a discounted cash flow analysis as of April 30, 2016 and 2015. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction.

Based on the Company’s ability to access its cash and cash equivalents, expected operating cash flows, and other sources of cash, the Company does not anticipate the current lack of liquidity on these investments will affect its ability to operate the business in the ordinary course. The Company believes the current lack of liquidity of these investments is temporary and expects that the securities will be redeemed or refinanced at some point in the future. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible impairment if a further decline in fair value occurs. The auction rate securities have been in an unrealized loss position for more than 12 months. The Company has the ability and the intent to hold these investments until a recovery of fair value, which may be maturity and as of April 30, 2016, it did not consider these investments to be other than temporarily impaired.

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

	April 30, 2016	2015
Auction rate securities		
Amortized cost	$ 3,100	$ 3,200
Gross unrealized losses	(320)	(359)
Fair value	$ 2,780	$ 2,841

The amortized cost and fair value of the Company's auction rate securities by contractual maturity at April 30, 2016 are as follows (in thousands):

	Cost	Fair Value
Due after one through five years	$ 1,100	$ 1,060
Due after 10 years	2,000	1,720
Total	$ 3,100	$ 2,780

Equity Securities

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

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

In August 2015, the Company sold its remaining shares in CybAero in a private sale at the price of 12.00 SEK per share, resulting in proceeds of approximately $777,000. During the fiscal year ended April 30, 2016, the Company realized gains on the sale of CybAero shares of $207,000, based on the difference between the original conversion price of 9.41 SEK per share and the sales price at the time of sale, inclusive of the final sale of all shares. During the fiscal year ended April 30, 2015, the Company realized gains on the sale of CybAero shares of $4,784,000. At April 30, 2016, the Company did not hold any CybAero stock.

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

	April 30, 2016	2015
Equity Securities		
Amortized cost	$ —	$ 3,357
Gross unrealized gains	—	—
Gross unrealized losses	—	(1,884)
Fair value	$ —	$ 1,473

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 April 30, 2016, were as follows (in thousands):

Fair Value Measurement Using
Significant

Description	Quoted prices in active markets for identical assets (Level 1)	other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Auction rate securities	$ —	$ —	$ 2,780	$ 2,780
Equity securities	—	—	—	—
Total	$ —	$ —	$ 2,780	$ 2,780

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The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis in the table above that used significant unobservable inputs (Level 3) (in thousands):

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
Balance at May 1, 2015	$ 2,841
Transfers to Level 3	—
Total gains (realized or unrealized)	
Included in earnings	—
Included in other comprehensive income	27
Purchases, issuances and settlements, net	(88)
Balance at April 30, 2016	$ 2,780
The amount of total gains or (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at April 30, 2016	$ —

The auction rate securities are valued using a discounted cash flow model. The analysis considers, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the estimated date upon which the security is expected to have a successful auction. As of April 30, 2016, the inputs used in the Company’s discounted cash flow analysis included current coupon rates of 0.1%, estimated redemption periods of 3 to 18 years and discount rates of 4.9% to 15.1%. 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.

4. Inventories, net

Inventories consist of the following:

	April 30, 2016	2015
	(In thousands)	
Raw materials	$ 11,609	$ 13,325
Work in process	4,259	5,140
Finished goods	26,073	25,537
Inventories, gross	41,941	44,002
Reserve for inventory excess and obsolescence	(4,455)	(4,588)

Inventories, net	$ 37,486	$ 39,414

Inventory held at third parties as of April 30, 2016 and 2015 was $5,329,000 and $6,840,000, respectively.

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5. Intangibles

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

	April 30, 2016	2015
	(In thousands)	
Licenses	$ 818	$ 818
Less accumulated amortization	(518)	(438)
Intangibles, net	$ 300	$ 380

The weighted average amortization period at April 30, 2016 and 2015 was four years and five years, respectively. Amortization expense for the years ended April 30, 2016, 2015 and 2014 was $80,000, $249,000 and $154,000, respectively.

During the fiscal year ended April 30, 2015, the Company recorded an impairment charge of $438,000 recorded in SG&A expenses related to an exclusive distribution agreement as the Company determined that it would not be selling any products through the exclusive distribution agreement.

During the fiscal year ended April 30, 2014, the Company recorded an impairment charge of $72,000 recorded in SG&A expenses related to a license for certain technology as the Company determined that it would not be selling any products containing the licensed technology.

During the fiscal year ended April 30, 2014, the Company recorded an impairment charge of $672,000 recorded in SG&A expenses related to an exclusive distribution license. See Note 6, Property and Equipment, net for further details.

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

Year ending April 30,	(In thousands)

2017	$	80
2018		80
2019		80
2020		60
2021		—
	$	300

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6. Property and Equipment, net

Property and equipment consist of the following:

	April 30, 2016	2015
	(In thousands)	
Leasehold improvements	$ 8,939	$ 9,117
Machinery and equipment	48,034	45,525
Furniture and fixtures	1,730	1,877
Computer equipment and software	30,171	26,223
Construction in process	3,885	1,634
Property and equipment, gross	92,759	84,376
Less accumulated depreciation and amortization	(75,997)	(70,877)
Property and equipment, net	$ 16,762	$ 13,499

Depreciation expense for the years ended April 30, 2016, 2015 and 2014 was $5,993,000, $8,116,000 and $8,930,000, respectively. At April 30, 2016, property and equipment includes computer equipment and software under capital leases with a cost basis of $1,836,000 and accumulated depreciation of $1,058,000. Depreciation of computer equipment and software under capital leases was $455,000 for the fiscal year ended April 30, 2016. Refer also to Out-of-Period Adjustments disclosure within Note 1, Organization and Significant Accounting Policies.

At April 30, 2014, an analysis of the Company's long lived assets related to Tier II helicopter demonstration assets and an exclusive license agreement to sell Tier II helicopters indicated impairment. At April 30, 2014 the Company determined that the carrying value of the Tier II helicopter demonstration assets and license agreement would not be recovered over the estimated useful life of the primary assets due to the delay of market adoption resulting in lower than anticipated sales. Accordingly, the Company completed an impairment test for this asset group, which resulted in an impairment charge of $3,317,000 that was recorded in SG&A costs of which $2,645,000 was related to the Tier II helicopter demonstration assets and $672,000 was related to the exclusive distribution license. To determine the amount of the impairment charge, the Company was required to make estimates of the fair value of the assets in this group, and these estimates were based on the use of the income approach to determine the fair value of the equipment.

7. Investments in Companies Accounted for Using the Equity Method

In March of 2014, the Company purchased 49% of the outstanding common stock of Altoy Savunma Sanayi ve Havacilik Anonim Sirketi ("Altoy"), a Turkish corporation founded in February 2014. Altoy aims to develop and manufacture high altitude, long endurance, unmanned aerial platform technologies in Turkey and market and sell such technologies to the world market. Altoy is considered to be in a start up phase with limited current operations. During the years ended April 30, 2016 and 2015, the Company recorded 49% of the net loss of Altoy, or $138,000 and $240,000, respectively, in "Other (expense) income" in the consolidated statement of income. At April 30, 2016 and 2015, the carrying value of the investment in Altoy was $386,000 and $230,000, respectively, and was recorded in "Other assets, long term."

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8. Warranty Reserves

Warranty reserve activity is summarized as follows:

	April 30,	
	2016	2015
	(In thousands)	
Beginning balance	$ 2,653	$ 1,280
Warranty expense	4,516	2,919
Changes in estimates related to pre-existing warranties	(424)	—
Warranty costs settled	(2,611)	(1,546)
Ending balance	$ 4,134	$ 2,653

9. Employee Savings Plan

The Company has an employee 401(k) savings plan covering all eligible employees. The Company expensed approximately $3,028,000, $2,818,000 and $2,757,000 in contributions to the plan for the years ended April 30, 2016, 2015 and 2014, respectively.

10. Severance Charges

During the fiscal year ended April 30, 2016, the Company made certain strategic headcount reductions with a total cost of approximately $933,000, consisting entirely of severance payments. The Company recorded this charge during its fourth fiscal quarter ended April 30, 2016. Of the total, approximately $362,000 was recorded to cost of sales and $571,000 was recorded to SG&A. Of the total recorded to cost of sales, approximately $300,000 related to UAS and approximately $62,000 to EES. The Company does not report SG&A costs by segment as the CODM only reviews the revenue and gross margin results for each of these segments when making resource allocation decisions. Of the total, approximately $834,000 was in accrued wages and related accruals at April 30, 2016.

11. Stock Based Compensation

For the years ended April 30, 2016, 2015 and 2014, the Company recorded stock based compensation expense of approximately $4,562,000, $3,768,000 and $3,622,000, respectively.

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

The Company had an equity incentive plan, or 2002 Plan, for officers, directors and key employees. Under the 2002 Plan, incentive stock options or nonqualified stock options were granted, as determined by the administrator at the time of grant. Stock purchase rights were also granted under the 2002 Plan. Options under the 2002 Plan were granted at their fair market value (as determined by the board of directors). The options became exercisable at various times over a

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five-year period from the grant date. The 2002 Plan was terminated on the effective date of the 2006 Plan. Awards outstanding under the 2002 Plan remain outstanding and exercisable; no additional awards may be made under the 2002 Plan.

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

The fair value of stock options granted was estimated at the grant date using the Black Scholes option pricing model with the following weighted average assumptions for the years ended April 30, 2016, 2015 and 2014:

	Year Ended April 30,		
	2016	2015	2014
Expected term (in years)	6.00	6.00	6.08
Expected volatility	36.14%	44.65%	45.61%
Risk-free interest rate	1.88 %	1.92 %	1.64 %
Expected dividend	—	—	—
Weighted average fair value at grant date	$ 10.18	$ 14.05	$ 10.61

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

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

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

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

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Information related to the stock option plans at April 30, 2016, 2015 and 2014, and for the years then ended is as follows:

	Restated 2006 Plan		2002 Plan		1992 Plan	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at April 30, 2013	892,210	$ 23.67	177,389	$ 3.98	181,569	$ 0.52
Options granted	125,000	23.39	—	—	—	—
Options exercised	(261,900)	24.45	(121,841)	2.25	(76,490)	0.42
Options canceled	(42,200)	26.05	(7,037)	11.79	—	—
Outstanding at April 30, 2014	713,110	23.20	48,511	7.18	105,079	0.52
Options granted	85,599	31.27	—	—	—	—
Options exercised	(30,000)	23.81	(3,518)	2.13	(1,500)	0.59
Options canceled	(111,592)	24.75	—	—	—	—
Outstanding at April 30, 2015	657,117	23.96	44,993	7.57	103,579	0.59
Options granted	128,000	26.83	—	—	—	—
Options exercised	(43,000)	21.81	(31,161)	5.70	(10,720)	0.59
Options canceled	(58,318)	25.98	(8)	2.13	—	—
Outstanding at April 30, 2016	683,799	24.46	13,824	11.79	92,859	0.59
Options exercisable at April 30, 2016	391,286	$ 23.48	13,824	$ 11.79	92,859	$ 0.59

The total intrinsic value of all options exercised during the years ended April 30, 2016, 2015 and 2014 was approximately $1,218,000, $455,000, and $9,220,000, respectively. The intrinsic value of all options outstanding at April 30, 2016 and 2015 was $6,060,000 and $5,349,000, respectively. The intrinsic value of all exercisable options at April 30, 2016 and 2015 was $5,047,000 and $4,560,000, respectively.

A summary of the status of the Company's non vested stock options as of April 30, 2016 and the year then ended is as follows:

Non-vested Options	Options	Weighted Average Grant Date Fair Value
Non-vested at April 30, 2015	293,907	$ 10.43
Granted	128,000	10.18
Expired	—	—
Canceled	(37,577)	10.50

Vested	(91,817)		9.75
Non-vested at April 30, 2016	292,513	$	10.53

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As of April 30, 2016, there was approximately $9,872,000 of total unrecognized compensation cost related to non vested share based compensation awards granted under the equity plans. That cost is expected to be recognized over an approximately five year period or a weighted average period of approximately three years.

The weighted average fair value of options issued for the years ended April 30, 2016, 2015 and 2014 was $10.18, $14.05 and $10.61, respectively. The total fair value of shares vesting during the years ended April 30, 2016, 2015 and 2014 was $2,965,000, $2,389,000 and $2,168,000, respectively.

Proceeds from all option exercises under all stock option plans for the years ended April 30, 2016, 2015 and 2014 were approximately $1,122,000, $722,000 and $6,709,000, respectively. The tax benefit realized from stock based compensation during the years ended April 30, 2016, 2015 and 2014 was approximately $98,000, $191,000, and $2,953,000, respectively.

The following tabulation summarizes certain information concerning outstanding and exercisable options at April 30, 2016:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	As of April 30, 2016	Weighted Average Remaining Contractual Life In Years	Weighted Average Exercise Price	As of April 30, 2016	Weighted Average Exercise Price
$ 0.59	92,859	3.47	$ 0.59	92,859	$ 0.59
11.79	13,824	0.40	11.79	13,824	11.79
18.07 - 24.65	363,910	3.74	21.15	288,510	21.51
25.77 - 32.19	319,889	7.68	28.23	102,776	29.02
$ 0.59 - 32.19	790,482	5.24	$ 21.43	497,969	$ 18.89

The remaining weighted average contractual life of exercisable options at April 30, 2016 was 3.55 years.

Information related to the Company’s restricted stock awards at April 30, 2016 and for the year then ended is as follows:

	Restated 2006 Plan	
	Shares	Weighted Average Grant Date Fair Value
Unvested stock at April 30, 2015	397,026	$ 26.20
Stock granted	191,548	25.21
Stock vested	(114,457)	25.91
Stock canceled	(47,053)	24.17
Unvested stock at April 30, 2016	427,064	$ 25.99

12. Long Term Incentive Awards

During the year ended April 30, 2016, the Company granted a three-year performance award under the Restated 2006 Plan to key employees. The performance period for each three-year award is the three year period ending April 30, 2018. A target payout was established at the award date. The actual payout at the end of the performance period will be

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calculated based upon the Company’s achievement of revenue and gross margin for the performance period. Payouts will be made in cash and restricted stock units. Upon vesting of the restricted stock units, the Company has the discretion to settle the restricted stock units in cash or stock.

During the year ended April 30, 2015, the Company granted a performance award under the Restated 2006 Plan to key employees. The performance period for the award is the three-years ending April 30, 2017. A target payout was established at the award date. The actual payout at the end of the performance period will be calculated based upon the Company’s achievement of revenue and gross margin for the fiscal year ending April 30, 2017. Payouts will be made in cash and restricted stock units. Upon vesting of the restricted stock units, the Company has the discretion to settle the restricted stock units in cash or stock.

During the year ended April 30, 2014, the Company granted a three-year performance award under the Restated 2006 Plan to key employees. The performance period for each three year award is the three year period ending April 30, 2016. A target payout was established at the beginning of the performance period. The actual payout at the end of the performance period will be calculated based upon the Company’s achievement of revenue and operating profit growth targets. Payouts will be made in cash and restricted stock units. Upon vesting of the restricted stock units, the Company has the discretion to settle the restricted stock units in cash or stock. The revenue and operating targets under the plan were not achieved, and therefore, no amounts will be paid out on the 2014 long-term incentive awards.

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

During the years ended April 30, 2016, 2015 and 2014, the Company recorded compensation expense for the long term incentive awards of $0, $0 and $160,000, respectively. At April 30, 2016 and 2015, the Company had an accrued liability of $0 for outstanding awards. The maximum compensation expense that may be recorded for outstanding awards is $6,409,000.

13. Income Taxes

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

	Year Ended April 30,		
	2016	2015	2014
Domestic	$ 8,125	$ 2,138	$ 14,996
Foreign	(57)	(245)	(100)
Total	$ 8,068	$ 1,893	$ 14,896

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

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

	Year Ended April 30,		
	2016	2015	2014
U.S. federal statutory income tax rate	35.0 %	35.0 %	35.0 %
State and local income taxes, net of federal benefit	(15.3)	(84.4)	(17.0)
R&D and other tax credits	(49.9)	(172.3)	(21.5)
Valuation allowance	17.1	96.7	8.7
Uncertain tax position adjustment	—	(1.9)	4.4
Return to provision adjustments	6.1	78.3	(0.1)
Permanent items	(2.6)	(5.2)	(1.3)
Other	(1.5)	0.9	(0.3)
Effective income tax rate	(11.1)%	(52.9) %	7.9 %

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

	Year Ended April 30,		
	2016	2015	2014
Current:			
Federal	$ 1,804	$ 573	$ 4,307
State	154	(1,292)	(1,879)
	1,958	(719)	2,428
Deferred:			
Federal	(2,859)	(1,972)	(1,694)
State	3	1,689	444
	(2,856)	(283)	(1,250)
Total income tax (benefit) expense	$ (898)	$ (1,002)	$ 1,178

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

	April 30, 2016	2015
Deferred income tax assets:		
Accrued expenses	$ 8,238	$ 8,442
Allowances, reserves, and other	1,330	1,543
Unrealized loss on securities	119	—
Net operating loss and credit carry-forwards	9,554	5,692
Intangibles basis	416	464
Total deferred income tax assets	19,657	16,141
Deferred income tax liabilities:		
Unrealized gain on securities	—	(237)
Fixed asset basis	(395)	(86)
Total deferred income tax liabilities	(395)	(323)
Valuation allowance	(4,511)	(3,127)
Net deferred tax assets	$ 14,751	$ 12,691

At April 30, 2016 and 2015 the Company recorded a valuation allowance of $4,511,000 and $3,127,000, respectively, against state R&D credits as the Company is currently generating more tax credits than it will utilize in future years and against foreign net operating losses that are not more likely than not to be utilized. The valuation allowance increased by $1,383,000 and $1,829,000 for April 30, 2016 and April 30, 2015, respectively.

At April 30, 2016 the Company had state credit carryforwards of $16,533,000 that do not expire and federal tax credit carryforwards of $6,144,000 that expire in 2034. As of April 30, 2016, the Company had federal and state credits of $265,000 and $33,000, respectively, for which the tax benefit, when recognized, will be recorded in equity.

At April 30, 2016, the Company had multiple state net operating loss carryforwards and had foreign losses of approximately $130,000 and $99,000,respectively. The state net operating loss carryforwards begin to expire in 2023 and the foreign losses carryforward indefinitely.

At April 30, 2016 and 2015, the Company had approximately $9,905,000 and $8,190,000, respectively, of unrecognized tax benefits all of which would impact the Company's effective tax rate if recognized. The Company estimates that none of its unrecognized tax benefits will decrease in the next twelve months due to statute of limitation expiration.

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the Emerging Issues Task Force). As a result of the adoption of this guidance the Company reclassified $2,484,000 at April 30, 2015 from the liability for uncertain tax positions to reduce deferred income tax assets on the balance sheet.

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The following table summarizes the activity related to the Company's gross unrecognized tax benefits for the years ended April 30, 2016 and 2015 (in thousands):

	April 30, 2016	2015
Balance as of May 1	$ 8,190	$ 6,334
Increases related to prior year tax positions	581	747
Decreases related to prior year tax positions	—	(12)
Increases related to current year tax positions	1,144	1,158
Decreases related to lapsing of statute of limitations	(10)	(37)
Balance as of April 30,	$ 9,905	$ 8,190

The Company records interest and penalties on uncertain tax positions to income tax expense. As of April 30, 2016 and 2015, the Company had accrued approximately $55,000 and $43,000, respectively, of interest and penalties related to uncertain tax positions. The Company is currently under audit by various state jurisdictions but does not anticipate any material adjustments from these examinations. The tax years 2011 to 2015 remain open to examination by the IRS for federal income taxes. The tax years 2008 to 2015 remain open for major state taxing jurisdictions.

14. 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, 2015	$ (1,358)	$ (1,358)
Reclassifications out of accumulated other comprehensive loss, net of $754 of taxes	1,130	1,130
Unrealized gains, net of $18 of taxes	27	27
Balance as of April 30, 2016	$ (201)	$ (201)

15. Changes in Accounting Estimates

During the years ended April 30, 2016, 2015 and 2014, the Company revised its estimates at completion of various fixed-price contracts which resulted in cumulative catch up adjustments during the year in which the change in estimate occurred. The change in estimate was a result of the Company changing the total costs required to complete the contracts due to having more accurate cost information as work progressed in subsequent periods on the various contracts. The changes in estimates resulted in cumulative catch-up adjustments to income from continuing operations for the years ended April 30, 2016, 2015 and 2014 that were not material.

16. Related Party Transactions

Pursuant to a consulting agreement, the Company paid a board member approximately $96,000 for each of the years ended April 30, 2016, 2015 and 2014, respectively, for consulting services independent of his board service.

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17. Commitments and Contingencies

Commitments

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

	Year ending April 30, (In thousands)	
	Operating leases	Capital leases
2017	$ 4,347	$ 424
2018	3,450	304
2019	3,012	168
2020	2,854	—
2021	2,006	—
Thereafter	4,236	—
	$ 19,905	896
Less: amounts representing interest		(57)
Present value of capital lease obligations		839
Less: Current portion		(390)
Long-term portion of capital lease obligations		$ 449

Rental expense under operating leases was approximately $4,820,000, $4,350,000 and $4,981,000 for the years ended April 30, 2016, 2015 and 2014, respectively.

Contingencies

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

At April 30, 2016 and 2015, the Company had outstanding letters of credit totaling $1,080,000 and $1,755,000, respectively.

Contract Cost Audits

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

For example, during the course of its audits, the DCAA may question the Company’s incurred costs, and if the DCAA believes the Company has accounted for such costs in a manner inconsistent with the requirements under Federal Acquisition Regulations, or FAR, the DCAA auditor may recommend to the Company’s administrative contracting

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officer to disallow such costs. Historically, the Company has not experienced material disallowed costs as a result of government audits. However, the Company can provide no assurance that the DCAA or other government audits will not result in material disallowances for incurred costs in the future.

The Company's revenue recognition policy calls for revenue recognized on all cost reimbursable government contracts to be recorded at actual rates unless collectability is not reasonably assured.

The Defense Contract Management Agency, or DCMA, disallowed a portion of the Company's executive compensation and/or other costs included in the Company's fiscal 2006, 2007 and 2008 incurred cost claims and sought interest for all three years and penalties for Fiscal 2006, based on the disallowed costs. The Company appealed these cost disallowances to the Armed Services Board of Contract Appeals. For Fiscal 2006, as a result of partial settlements and a decision of the Armed Services Board of Contract Appeals in March 2016, the government's remaining claims were dismissed with prejudice. All of the government's claims related to the Company's 2007 and 2008 incurred cost claims were settled as of October 2015 by payment to the government of $50,000 and the government's claims related to the Company's 2009 and 2010 incurred cost claims were settled as of October 2015 and April 2016, respectfully, without the payment of any consideration.

As a result of the settlement agreements and the Armed Services Board of Contract Appeals ruling, the Company reversed reserves of $3,607,000 related to those fiscal years as a credit to cost of sales, allocated as $3,203,000 to the UAS segment and $404,000 to the EES segment during the fiscal year ended April 30, 2016. At April 30, 2016, the Company did not have any remaining reserves for incurred cost claim audits.

18. Segment Data

The Company's product segments are as follows:

- Unmanned Aircraft Systems—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—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.

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

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The segment results are as follows (in thousands):

	Year Ended April 30,		
	2016	2015	2014
Revenue:			
UAS	$ 233,738	$ 220,950	$ 208,810
EES	30,360	38,448	42,893
Total	264,098	259,398	251,703
Cost of sales:			
UAS	132,209	128,233	127,992
EES	19,786	26,897	30,098
Total	151,995	155,130	158,090
Gross margin:			
UAS	101,529	92,717	80,818
EES	10,574	11,551	12,795
Total	112,103	104,268	93,613
Selling, general and administrative	60,077	55,763	55,679
Research and development	42,291	46,491	25,515
Income from operations	9,735	2,014	12,419
Interest income	1,032	882	855
Other (expense) income	(2,699)	(1,003)	1,622
Income before income taxes	$ 8,068	$ 1,893	$ 14,896

Geographic Information

Sales to non U.S. customers accounted for 28%, 9% and 14% of revenue for each of the fiscal years ended April 30, 2016, 2015 and 2014, respectively.

19. Quarterly Results of Operations (Unaudited)

The following tables present selected unaudited consolidated financial data for each of the eight quarters in the two year period ended April 30, 2016. In the Company’s opinion, this unaudited information has been prepared on the same basis as the audited information and includes all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of the financial information for the period presented. The Company’s fiscal year ends on April 30. Due to the fixed year end date of April 30, the first and fourth quarters each consist of approximately 13 weeks. The second and third quarters each consist of exactly 13 weeks. The first three quarters end on a Saturday.

	Three Months Ended			
	July 30, 2015	October 31, 2015	January 30, 2016	April 30, 2016
	(In thousands except per share data)			
Year ended April 30, 2016				
Revenue	$ 47,050	$ 64,731	$ 67,560	$ 84,757
Gross margin	$ 16,023	$ 31,533 (2)	$ 26,625	$ 37,922
Net (loss) income	$ (6,981) (1)	$ 4,419	$ 6,164 (3)	$ 5,364
Net (loss) income per share—basic(5)	$ (0.30)	$ 0.19	$ 0.27	$ 0.23
Net (loss) income per share—diluted(5)	$ (0.30)	$ 0.19	$ 0.27	$ 0.23

	Three Months Ended				
	August 2, 2014	November 1, 2014		January 31, 2015	April 30, 2015
	(In thousands except per share data)				
Year ended April 30, 2015					
Revenue	$ 51,866	$ 52,664		$ 68,397	$ 86,471
Gross margin	$ 14,054	$ 17,871	(4)	$ 26,993	$ 45,350
Net (loss) income	$ (3,609)	$ (2,901)		$ 2,325	$ 7,080
Net (loss) income per share—basic(5)	$ (0.16)	$ (0.13)		$ 0.10	$ 0.31
Net (loss) income per share—diluted(5)	$ (0.16)	$ (0.13)		$ 0.10	$ 0.31

(1) Includes an other-than-temporary-impairment loss of $2.2 million related to the Company's investment in the CybAero shares which was recorded to other expense, net in the consolidated statement of operations.
(2) Includes reversal of $3.5 million remaining reserve as a result of the settlement by the parties or the dismissal by the Armed Services Board of Contract Appeals of the government's claims related to the Company's incurred cost submittals for fiscal years 2006 through 2009 which was recorded as a credit to cost of sales.
(3) Includes the impact of $0.9 million of out-of-period expenses. Refer to Out-of-Period Adjustments within Note 1.
(4) Includes $2.6 million for a government contract accounting reserve for prior year incurred cost audit findings.
(5) Earnings per share is computed independently for each of the quarters presented. The sum of the quarterly earnings per share do not equal the total earnings per share computed for the year due to rounding.

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SUPPLEMENTARY DATA

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
	(In thousands)				
Allowance for doubtful accounts for the year ended April 30:					
2014	$ 936	$ (6)	$ —	$ (139)	$ 791
2015	$ 791	$ 106	$ —	$ (291)	$ 606
2016	$ 606	$ 178	$ —	$ (522)	$ 262
Warranty reserve for the year ended April 30:					
2014	$ 1,515	$ 1,436	$ —	$ (1,671)	$ 1,280
2015	$ 1,280	$ 2,919	$ —	$ (1,546)	$ 2,653
2016	$ 2,653	$ 4,516	$ (424)	$ (2,611)	$ 4,134
Reserve for inventory excess and obsolescence for the year ended April 30:					
2014	$ 3,871	$ 2,187	$ —	$ (2,824)	$ 3,234
2015	$ 3,234	$ 2,035	$ —	$ (681)	$ 4,588
2016	$ 4,588	$ 2,767	$ —	$ (2,900)	$ 4,455
Reserve for self-insured medical claims for the year ended April 30:					
2014	$ 1,543	$ 8,908	$ —	$ (9,170)	$ 1,281
2015	$ 1,281	$ 8,953	$ —	$ (8,941)	$ 1,293
2016	$ 1,293	$ 9,213	$ —	$ (9,330)	$ 1,176

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

Not applicable.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

Management’s Report on Internal Control Over Financial Reporting

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

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

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

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

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

Under the supervision and with the participation of management, including our principal executive and financial officers, we assessed our internal control over financial reporting as of April 30, 2016, based on criteria for effective internal control over financial reporting established in Internal Control—Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (COSO). Based on this assessment, management concluded that the Company maintained effective internal control over financial reporting as of April 30, 2016 based on the specified criteria.

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The effectiveness of our internal control over financial reporting as of April 30, 2016 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Changes in Internal Control over Financial Reporting

During the fourth quarter of our fiscal year ended April 30, 2016, we enhanced our internal controls over financial reporting. Specifically, we implemented additional controls which expand our review of the state use tax process. As a result of implementing these enhanced controls, we have remediated the material weakness in our sales and use tax process identified during the three and nine months ended January 30, 2016.

There were no other changes in our internal control over financial reporting or in other factors identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a 15 or 15d 15 that occurred during the quarter ended April 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

On March 23, 2016, we entered into an indemnification agreement (the “Indemnification Agreement”) with each of our executive officers and directors (collectively, the “Indemnitees”). The Indemnification Agreements supplement indemnification obligations contained in our Amended and Restated Certificate of Incorporation and Third Amended and Restated Bylaws and generally provide that we will indemnify the Indemnitees to the fullest extent permitted by Delaware law, subject to certain exceptions, against expenses, judgments, fines, amounts paid in settlement and other amounts actually and reasonably incurred in connection with their service as a director or officer. The Indemnification Agreements also provide for rights to advancement of expenses and contribution.

On March 7, 2016, we executed a consulting agreement (the “Consulting Agreement”) with one of our directors, Charles R. Holland. Under the Consulting Agreement, which has a one-year term from its effective date of January 1, 2016, Mr. Holland will provide consulting services to the Company, which services shall be described in task orders to be entered into between the Company and Mr. Holland during the term of the Consulting Agreement. In addition, on March 7, 2016, the Company and Mr. Holland executed a task order under the Consulting Agreement (the “Task Order) under which Mr. Holland will provide marketing support for unmanned air vehicle systems to the Company over the performance period of January 1, 2016 to December 31, 2016. The Company will pay Mr. Holland a monthly retainer of $8,000, with a maximum amount of $98,000 payable to Mr. Holland, including expenses, during the performance period under the Task Order.

The descriptions of the Indemnification Agreements, Consulting Agreement and Task Order set forth in this Item 9B are not complete and are qualified in their entirety by reference to the full text of the form of Indemnification Agreement and the full text of the Consulting Agreement and the Task Order which are filed as Exhibits 10.1, 10.31 and 10.32 to this Annual Report on Form 10-K and are incorporated herein by reference.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited AeroVironment Inc. and subsidiaries' internal control over financial reporting as of April 30, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). AeroVironment, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, AeroVironment, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of April 30, 2016, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of AeroVironment, Inc. and subsidiaries as of April 30, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended April 30, 2016 of AeroVironment, Inc. and subsidiaries and our report dated June 28, 2016 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Los Angeles, California
June 28, 2016

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PART III

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

Certain information required by Item 401 and Item 405 of Regulation S K will be included in the Proxy Statement for our 2015 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

Codes of Ethics

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

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

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

The information required by Item 407(d)(4) and (5) of Regulation S K will be included in the Proxy Statement for our 2016 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

Item 11. Executive Compensation.

The information required by Item 402 and Item 407(e)(4) and (5) of Regulation S K will be included in the Proxy Statement for our 2016 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

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

The information required by Item 201(d) and Item 403 of Regulation S K will be included in the Proxy Statement for our 2016 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

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

The information required by Item 404 and Item 407(a) of Regulation S K will be included in the Proxy Statement for our 2016 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

Item 14. Principal Accounting Fees and Services.

The information required by Item 14 will be included in the Proxy Statement for our 2016 Annual Meeting of Stockholders, and that information is incorporated by reference herein.

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PART IV

Item 15. Exhibits, Financial Statement Schedules.

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

1. Financial Statements

The following consolidated financial statements are included in Item 8:

· Report of Independent Registered Public Accounting Firm

· Consolidated Balance Sheets at April 30, 2016 and 2015

· Consolidated Statements of Income for the Years ended April 30, 2016, 2015 and 2014

· Consolidated Statements of Comprehensive Income for the Years Ended April 30, 2016, 2015 and 2014

· Consolidated Statements of Stockholders' Equity for the Years ended April 30, 2016, 2015 and 2014

· Consolidated Statements of Cash Flows for the Years ended April 30, 2016, 2015 and 2014

· Notes to Consolidated Financial Statements

2. Financial Statement Schedules

The following Schedule is included in Item 8:

· Schedule II—Valuation and Qualifying Accounts

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

3. Exhibits

See Item 15(b) of this report below.

(b) Exhibits

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

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Exhibit Number	Exhibit
10.8#(3)	AeroVironment, Inc. 2006 Equity Incentive Plan
10.9#(4)	AeroVironment, Inc. 2006 Equity Incentive Plan, as amended and restated effective September 29, 2012
10.10#(3)	Form of Stock Option Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.11#(3)	Form of Performance Based Bonus Award pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.12#(5)	Form of Long Term Compensation Award Grant Notice and Long Term Compensation Award Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.13#(2)	Form of Restricted Stock Award Grant Notice and Restricted Stock Award Agreement pursuant to the AeroVironment, Inc. 2006 Equity Incentive Plan
10.14(6)	Standard Industrial/Commercial Single Tenant Lease, dated February 12, 2007, between AeroVironment, Inc. and OMP Industrial Moreland, LLC, for the property located at 85 Moreland Road, Simi Valley, California, including the addendum thereto
10.15(7)	Standard Industrial/Commercial Single Tenant Lease, dated March 3, 2008, between AeroVironment, Inc. and Hillside Associates III, LLC, for the property located at 900 Enchanted Way, Simi Valley, California, including the addendum thereto
10.16(7)	Standard Industrial/Commercial Single Tenant Lease, dated April 21, 2008, between AeroVironment, Inc. and Hillside Associates II, LLC, for the property located at 994 Flower Glen Street, Simi Valley, California, including the addendum thereto
10.17(8)	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
10.18(8)	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
10.19(8)	Lease Agreement (996 Flower Glen Street, Simi Valley, CA 93065) dated as of December 1, 2013, by and between the Company and Hillside II LLC, and related agreements
10.20(9)	Standard Multi-Tenant Office Lease — Gross, dated September 24, 2015, between AeroVironment, Inc. and Monrovia Technology Campus LLC for property at 800 Royal Oaks Dr. Monrovia, California, including addendums thereto
10.21#(3)	Retiree Medical Plan
10.22†(10)	Award Contract, dated March 1, 2011, between AeroVironment, Inc. and United States Army Contracting Command
10.23†(11)	Contract modification P00015 dated September 5, 2013 under the base contract with the US Army Contracting Command—Redstone Arsenal (Missile) dated August 30, 2012
10.24(12)	Consulting Agreement, dated February 5, 2015, between Jikun Kim and AeroVironment, Inc.
10.25#(13)	Offer Letter, dated June 15, 2015 from AeroVironment, Inc. to Raymond D. Cook
10.26#(14)	Form of Severance Protection Agreement dated as of December 10, 2015, by and between AeroVironment, Inc. and each non-CEO executive officer
10.27(14)	Form of Director Letter Agreement by and between AeroVironment, Inc. and each non-employee director
10.28#(15)	Separation Agreement by and between AeroVironment, Inc. and Cathleen Cline dated as of April 28, 2016
10.29(15)	Consulting Agreement by and between AeroVironment, Inc. and Cathleen Cline dated as of April 28, 2016
10.30	Severance Protection Agreement dated as of May 2, 2016, by and between AeroVironment, Inc. and Wahid Nawabi
10.31	

Consulting Agreement by and between AeroVironment, Inc. and Charles R. Holland executed as of March 7, 2016

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Exhibit Number	Exhibit
10.32	Task Order #FY16-001 to Consulting Agreement by and between AeroVironment, Inc. and Charles R. Holland executed as of March 7, 2016
21.1	Subsidiaries of AeroVironment, Inc.
23.1	Consent of Ernst & Young LLP, independent registered public accounting firm
24.1	Power of Attorney (incorporated by reference to the signature page of this Annual Report)
31.1	Certification Pursuant to Rule 13a 14(a) or Rule 15d 14(a) of the Securities Exchange Act of 1934
31.2	Certification Pursuant to Rule 13a 14(a) or Rule 15d 14(a) of the Securities Exchange Act of 1934
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#Indicates management contract or compensatory plan.

(c)Not applicable.

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SIGNATURES

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

AEROVIRONMENT, INC.

Date: June 28, 2016		/s/ Wahid Nawabi
	By:	Wahid Nawabi
	Its:	Chief Executive Officer and President
		(Principal Executive Officer)

POWER OF ATTORNEY

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

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

Name	Title	Date
/s/ Wahid Nawabi Wahid Nawabi	President and Chief Executive Officer and Director (Principal Executive Officer)	June 28, 2016
/s/ Raymond D. Cook Raymond D. Cook	Chief Financial Officer (Principal Financial and Accounting Officer)	June 28, 2016
/s/ Timothy E. Conver Timothy E. Conver	Chairman	June 28, 2016

/s/ Edward R. Muller Edward R. Muller	Director	June 28, 2016
/s/ Arnold L. Fishman Arnold L. Fishman	Director	June 28, 2016
/s/ Stephen F. Page Stephen F. Page	Director	June 28, 2016
/s/ Charles R. Holland Charles R. Holland	Director	June 28, 2016
/s/ Catharine Merigold Catharine Merigold	Director	June 28, 2016
/s/ Charles Thomas Burbage Charles Thomas Burbage	Director	June 28, 2016