INNOVATIVE SOLUTIONS & SUPPORT INC
Form 10-Q
August 06, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2008

OR

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

[For the transition period from to]

Commission File No. 0-31157

INNOVATIVE SOLUTIONS AND SUPPORT, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA (State or other jurisdiction of incorporation)	**23-2507402** (IRS Employer Identification No.)
720 Pennsylvania Drive, Exton, Pennsylvania	**19341**

(Address of principal executive offices)	(Zip Code)

(610) 646-9800
(Registrant s telephone number, including area code)

Indicate by check mark whether 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 day.

Yes x No o

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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of August 1, 2008, there were 16,904,514 shares of the Registrant s Common Stock, with par value of $.001 per share, outstanding.

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

INNOVATIVE SOLUTIONS AND SUPPORT, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

	As of June 30, 2008	As of September 30, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 41,070,896	$ 49,151,078
Accounts receivable	4,963,603	6,248,606
Inventories	10,953,948	9,363,795
Deferred income taxes	46,343	899,895
Prepaid expenses and other current assets	1,274,872	6,208,804
Total current assets	58,309,662	71,872,178
Property and Equipment:		
Computers and test equipment	5,877,489	5,444,737
Corporate airplane	3,076,400	3,058,627
Furniture and office equipment	1,074,029	1,016,954
Manufacturing facility	5,576,536	5,557,048
Land	1,021,245	1,021,245
	16,625,699	16,098,611
Less- Accumulated depreciation and amortization	(7,439,886)	(6,721,274)
Net property and equipment	9,185,813	9,377,337
Deferred income taxes		328,060
Other assets	505,780	3,008,210
Total assets	$ 68,001,255	$ 84,585,785
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Current portion of capitalized lease obligations	$ 9,908	$ 9,908
Accounts payable	2,941,848	4,077,789
Accrued expenses	3,107,057	4,670,832
Deferred revenue	489,750	660,415
Total current liabilities	6,548,563	9,418,944
Note payable	4,335,000	4,335,000
Long-term portion of capitalized lease obligations	40,170	47,542
Deferred revenue	2,949	50,520
Deferred income taxes	46,343	
Other liabilities	223,893	
Commitments and contingencies		

Total liabilities		11,196,918		13,852,006
Shareholders Equity:				
Preferred stock, 10,000,000 shares authorized, $.001 par value, of which 200,000 shares are authorized as Class A Convertible stock. No shares issued and outstanding at June 30, 2008 and September 30, 2007				
Common stock, $.001 par value: 75,000,000 shares authorized, 18,174,394 and 18,161,172 shares issued at June 30, 2008 and September 30, 2007		18,174		18,161
Additional paid-in capital		45,619,362		44,607,993
Retained earnings		29,310,407		44,194,053
Treasury stock, at cost, 1,279,510, shares at June 30, 2008 and 1,272,510 shares at September 30, 2007		(18,143,606)		(18,086,428)
Total shareholders equity		56,804,337		70,733,779
Total liabilities and shareholders equity	$	68,001,255	$	84,585,785

The accompanying notes are an integral part of these statements.

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INNOVATIVE SOLUTIONS AND SUPPORT, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended June 30 2008	Three Months Ended June 30 2007	Nine Months Ended June 30 2008	Nine Months Ended June 30 2007
Net sales:				
Product	$ 7,178,212	$ 3,981,660	$ 17,290,973	$ 10,316,479
Engineering - Modification & Development	1,573,097	1,862,745	3,020,343	2,911,872
Total net sales	8,751,309	5,844,405	20,311,316	13,228,351
Cost of sales				
Product	3,850,657	1,985,572	10,331,738	6,027,327
Engineering - Modification & Development	717,646	1,653,663	1,686,285	2,663,881
Total cost of sales	4,568,303	3,639,235	12,018,023	8,691,208
Gross profit	4,183,006	2,205,170	8,293,293	4,537,143
Operating expenses:				
Research and development	3,221,698	1,107,385	7,738,942	3,912,480
Selling, general and administrative	3,282,183	4,192,013	13,952,535	11,124,795
Asset Impairment	2,475,000		2,475,000	
Total operating expenses	8,978,881	5,299,398	24,166,477	15,037,275
Operating loss	(4,795,875)	(3,094,228)	(15,873,184)	(10,500,132)
Interest income- net	251,015	728,454	1,193,036	2,234,718
Other income			300,000	
Loss before income taxes	(4,544,860)	(2,365,774)	(14,380,148)	(8,265,414)
Income tax expense (benefit)	(255,989)	(1,014,917)	1,090,821	(3,456,967)
Net loss	$ (4,288,871)	$ (1,350,857)	$ (15,470,969)	$ (4,808,447)
Net loss per common share:				
Basic	$ (0.25)	$ (0.08)	$ (0.92)	$ (0.29)
Diluted	$ (0.25)	$ (0.08)	$ (0.92)	$ (0.29)
Weighted average shares outstanding:				
Basic	16,893,499	16,881,900	16,897,313	16,857,164
Diluted	16,893,499	16,881,900	16,897,313	16,857,164

The accompanying notes are an integral part of these statements.

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INNOVATIVE SOLUTIONS AND SUPPORT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	For the Nine Months Ended June 30 2008	For the Nine Months Ended June 30 2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (15,470,969)	$ (4,808,447)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	761,666	619,786
Share-based compensation expense:		
Stock options	809,792	361,869
Nonvested stock awards	149,940	170,000
Tax benefit from share-based arrangements:		
Stock options	12,491	164,680
Nonvested stock awards	6,286	37,449
Excess tax benefits from share-based payments arrangements		(156,442)
(Gain) loss on disposal of fixed assets	(3,000)	2,486
Excess and obsolete inventory expense	78,913	100,000
Asset impairment	2,475,000	
Deferred income taxes	1,227,955	(458,113)
(Increase) decrease in:		
Accounts receivable	1,285,003	1,545,161
Inventories	(1,669,066)	(1,245,857)
Prepaid expenses and other current assets	4,933,932	(3,751,173)
Other non current assets	(6,180)	
Increase (decrease) in:		
Accounts payable	(1,135,941)	3,639,053
Accrued expenses	(976,452)	478,290
Deferred revenue	(218,236)	(419,108)
Other non current liabilities	223,893	
Net cash used in operating activities	(7,514,973)	(3,720,366)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(536,532)	(596,698)
Purchases of other assets		(2,477,500)
Proceeds on sale of fixed assets	3,000	
Net cash used in investing activities	(533,532)	(3,074,198)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	32,873	487,218
Repayment of capitalized lease obligations	(7,372)	(6,141)
Purchase of treasury stock	(57,178)	
Excess tax benefits from share-based payments arrangements		156,442
Net cash provided by (used in) financing activities	(31,677)	637,519
Net decrease in cash and cash equivalents	(8,080,182)	(6,157,045)
Cash and cash equivalents, beginning of year	49,151,078	62,984,829
Cash and cash equivalents, end of period	$ 41,070,896	$ 56,827,784

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION				
Cash paid for interest	$	92,066	$	123,701
Cash paid for income taxes	$	9,073	$	
Cash received from income tax refund	$	(5,107,269)	$	(2,314,697)

The accompanying notes are an integral part of these statements.

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Innovative Solutions and Support Inc.
Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation:

Innovative Solutions and Support, Inc. (the Company) was incorporated in Pennsylvania on February 12, 1988. The Company s primary business is the design, manufacture and sale of flat panel display systems, flight information computers and advanced monitoring systems for military, government, commercial air transport and corporate aviation markets.

The balance sheet as of June 30, 2008, the statement of operations for the three months and nine months ended June 30, 2008 and 2007 and the statements of cash flows for the nine months ended June 30, 2008 and 2007 have been prepared by the Company without audit. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, necessary to present fairly the financial position, results of operations and cash flows at June 30, 2008 and for all periods presented have been made.

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. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company s Form 10-K for the year ended September 30, 2007 as filed with the Securities and Exchange Commission. The results of operations for the three months and nine months ended June 30, 2008 are not necessarily indicative of the operating results for the full year.

2. New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; however, the application of this Statement may change current practice for some entities. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this pronouncement.

3. Concentrations

For the three months ended June 30, 2008, three customers accounted for 44%, 15% and 14% of net sales or 73% on a combined basis. For the three months ended June 30, 2007, three customers accounted for 31%, 22% and 13% of net sales or 66% on a combined basis. For the nine months ended June 30, 2008, one customer accounted for 52% of net sales. For the nine months ended June 30, 2007, two customers accounted for 22% and 19% of net sales or 41% on a combined basis.

4. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market, net of reserve for excess and obsolete, and consist of the following:

	June 30, 2008	September 30, 2007
Raw materials	$ 6,991,180	$ 6,420,184
Work-in-process	2,850,703	2,216,111
Finished goods	1,112,065	727,500
	$ 10,953,948	$ 9,363,795

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5. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

	June 30, 2008	September 30, 2007
Prepaid income taxes	$ 36,564	$ 5,017,794
Revenue recognized - not billed	683,527	284,740
Other	554,781	906,270
	$ 1,274,872	$ 6,208,804

6. Accrued expenses

Accrued expenses consist of the following:

	June 30, 2008	September 30, 2007
Salary, benefits and payroll taxes	$ 1,112,260	$ 603,565
Warranty	706,813	592,524
Professional fees	341,820	1,515,630
Other	946,164	1,959,113
	$ 3,107,057	$ 4,670,832

7. Warranty

The Company provides for the estimated cost of product warranties at the time revenue is recognized. Warranty cost is recorded as cost of sales and the reserve balance recorded as an accrued expense in the financial statements. While the Company engages in extensive product quality programs and processes, the Company s warranty obligation is affected by product failure rates and the related material, labor and delivery costs incurred in correcting a product failure. Should actual product failure rates, material or labor costs differ from the Company s estimates, further revisions to the estimated warranty liability would be required.

Warranty cost and accrual information for the three months ended June 30, 2008 is highlighted below:

Warranty accrual at March 31, 2008	$ 673,198

Accrued expense for the three months ended June 30, 2008		83,138
Warranty costs for the three months ended June 30, 2008		(49,523)
Warranty accrual at June 30, 2008	$	706,813

Warranty cost and accrual information for the nine months ended June 30, 2008 is highlighted below:

Warranty accrual at September 30, 2007	$	592,524
Accrued expense for the nine months ended June 30, 2008		233,126
Warranty costs for the nine months ended June 30, 2008		(118,837)
Warranty accrual at June 30, 2008	$	706,813

8. Notes Payable

The Company entered into a $4,335,000 loan agreement dated August 1, 2000 with the Chester County, Pennsylvania Industrial Development Authority. The purpose of the loan was to fund the construction of the Company s new office and manufacturing facility. The loan matures in 2015 and carries an interest rate set by the remarketing agent that is consistent with 30-day tax-exempt

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commercial paper. The loan agreement includes an optional redemption schedule that allows the Company the option of forgoing any principal pay-down of the outstanding balance and, accordingly, the balance of the notes payable will be due in 2015.

In November 2007, the Company and the lender signed an amendment to the loan agreement which deleted existing financial covenants and replaced them with only one restrictive covenant that requires the Company to maintain at all times unencumbered cash and marketable securities having a market value of at least $20 million.

9. Share-Based Compensation

Effective October 1, 2005, the Company adopted the provisions of SFAS No.123(R), *Share-Based Payment* (SFAS 123(R)), using the modified prospective approach and now accounts for share-based compensation applying the fair value method for expensing stock options and non-vested stock awards.

Total share-based compensation expense was $400,000 and $198,000 for the three months ended June 30, 2008 and 2007, respectively. The income tax benefit recognized in the statement of operations for share-based compensation arrangements was $0 and $85,000 for the three months ended June 30, 2008 and 2007, respectively. Total share-based compensation expense was $960,000 and $532,000 for the nine months ended June 30, 2008 and 2007, respectively, and the income tax benefit recognized in the statement of operations for share based compensation arrangements was $0 and $222,000, respectively. Compensation expense related to share-based awards is recorded as a component of general and administrative expense.

The Company maintains the 1998 Stock Option Plan (the Plan) and the 2003 Restricted Stock Plan (the Restricted Plan). These plans were approved by the Company s shareholders.

Stock Options

The Plan provides for the granting of incentive and nonqualified stock options to employees, officers, directors and independent contractors and consultants. Through June 30, 2008, no stock options have been granted to independent contractors or consultants under this Plan. Total compensation expense was $350,000 and $138,000 for the three months ended June 30, 2008 and 2007, and $810,000 and $362,000 for the nine months ended June 30, 2008 and 2007, respectively. Incentive stock options granted under the Plan have exercise prices that must be at least equal to the fair value of the common stock on the date of grant. Nonqualified stock options granted under the Plan have exercise prices that may be less than, equal to or greater than the fair value of the common stock on the date of grant. The Company has reserved 3,389,000 shares of Common Stock for awards under the plan. As of June 30, 2008 there were 1,325,000 shares remaining and available for grant under the Plan.

A summary of option activity under the Plan as of June 30, 2008 and changes during the nine months ended June 30, 2008 is as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at September 30, 2007	572,959	$ 10.30		
Granted	409,000	10.16		
Exercised	(4,497)	7.31		
Cancelled	(49,554)	14.26		
Outstanding at June 30, 2008	927,908	$ 10.04	7.16	$ 474,337
Exercisable at June 30, 2008	417,808	$ 8.06	4.70	$ 469,155

The weighted-average grant date fair value of individual options granted during the nine months ended June 30, 2008 and 2007 was $5.05 and $14.38, respectively. The total intrinsic value of options exercised during the nine months ended June 30, 2008 and 2007 was $33,000 and $609,000, respectively.

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The following table summarizes information about stock options under the Plan at June 30, 2008:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding As of June 30, 2008	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	As of June 30, 2008	Weighted-Average Exercise Price
$0.00 - 5.00	201,909	4.54	$ 4.22	201,609	$ 4.22
$5.01 - 10.00	209,699	5.65	7.81	122,199	7.69
$10.01 - 15.00	413,600	9.10	11.25	43,300	13.84
$15.01 - 20.00	44,700	6.81	16.77	29,500	16.82
$20.01 - 26.97	58,000	8.21	24.62	21,200	22.75
	927,908	7.16	10.04	417,808	8.06

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. Options are exercised over a maximum term of ten years from the date of grant and vest over periods of two to five years from the grant date. The expected term of options represents the period of time that the options granted are expected to be outstanding and is based on historical experience. Expected volatility is based on historical volatility of the Company s stock. The risk free interest rate is based on U.S. Treasuries with constant maturities in effect at the time of the grant. Compensation expense for employee stock options also includes an estimate for forfeitures and is recognized ratably over the vesting term. The table below sets forth the fair value assumptions used to record compensation expense for the period identified:

	Nine Months Ended June 30, 2008	Nine Months Ended June 30, 2007
Expected lives (years)	7.39	9.06
Weighted average risk-free interest rate	2.2%	2.1%
Expected volatility	60.1%	65.3%
Expected dividend rate	%	%

As of June 30, 2008, there was approximately $2.5 million of unrecognized compensation cost, net of forfeitures, related to non-vested stock options, which is expected to be recognized over a period of approximately 5 years.

Non-vested Stock

The Restricted Plan for non-employee directors was approved by shareholders at the Company s February 26, 2004 Annual Meeting of Shareholders. The Plan calls for an annual award of non-vested stock having a fair market value of $40,000 as of the close of business on October 1 of the current fiscal year for all eligible non-employee directors. The stock is awarded in four quarterly installments during the fiscal year provided the director is still serving on the board on the quarterly issue date. Total expense was $50,000 and $60,000 for the three months ended June 30, 2008 and 2007 and $150,000 and $170,000 for the nine months ended June 30, 2008 and 2007, respectively. As of June 30, 2008, there was an estimated $50,000 of unrecognized compensation expense related to nonvested stock awards under the Company s Restricted Plan. That cost is expected to be recognized over the balance of the fiscal year. The following table outlines restricted stock awards for the nine months ended June 30, 2008:

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	Non-vested Stock Awards	Weighted Average Share Price
Balance at September 30, 2007	3,465	$ 14.43
Granted	10,525	19.00
Issued	(8,725)	17.19
Cancelled		
Balance at June 30, 2008	5,265	$ 19.00

10. Stock Repurchase Program

On February 21, 2008, the Company s Board of Directors approved a common stock repurchase program to acquire up to 1,000,000 shares of its outstanding common stock. The program will remain in effect until February 21, 2009, unless extended by the Board of Directors. For the three months ended June 30, 2008, there were no purchases of the Company common stock.

11. Asset Impairment

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144)* the Company recorded an asset impairment of $2.5 million, the full carrying value of the asset, during the three months ended June 30, 2008. The impairment was related to previously acquired engineering software which is no longer part of the Company s product offering and will generate no future cash flows.

12. Loss per Share

Loss per share (EPS) is calculated using the principles of SFAS No. 128, *Earnings Per Share.*

For the nine month periods ended June 30, 2008 and 2007, there were 928,000 and 576,000 options to purchase common stock outstanding, respectively, excluded from the computations of diluted earnings per share as the effect would be antidilutive.

13. Income Taxes

The Company adopted the provisions of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on October 1, 2007. Previously, the Company had accounted for tax contingencies in accordance with SFAS No. 5, *Accounting for Contingencies.* At the adoption date of October 1, 2007, the Company applied FIN 48 to all tax positions for which the statute of limitations remained open. As a result of the implementation of FIN 48, the Company recognized a decrease of approximately $587,000 in the liability for unrecognized tax benefits, which was accounted for as an increase to the October 1, 2007 balance of retained earnings.

The amounts of unrecognized tax benefits as of October 1, 2007 were approximately $330,000, all of which, if ultimately recognized, would reduce the Company s annual effective tax rate.

The Company is subject to income taxes in the U.S. federal and various state jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of related tax laws and regulations and require significant judgment to apply. With few significant exceptions, the Company is no longer subject to U.S. federal or state and local examinations by tax authorities for the years ending on or before September 30, 2003.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits in income tax expense for all periods presented. The Company had accrued approximately $30,000 for the payment of interest and penalties, net of deferred tax benefits, at October 1, 2007.

For the nine months ended June 30, 2008, the Company recognized $10,000 of interest and penalties within income tax expense.

During the quarter ended June 30, 2008, the Company recognized a tax benefit of $256,000 primarily related to the unrecognized tax benefit previously recorded that as a result of examination by the Internal Revenue Service, are considered effectively settled under FASB Staff Position FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48(FSP FIN 48-1).*

The Company s financial statements contain certain deferred tax assets which have arisen primarily as a result of tax benefits associated with the loss before income tax incurred during the nine months ended June 30, 2008, as well as deferred income tax assets resulting from temporary differences in prior tax years. SFAS No. 109, *Accounting for Income Taxes (SFAS 109)*, requires the consideration of a valuation allowance to reflect the likelihood of realization of deferred tax assets. Significant management judgment is required in determining any valuation allowance recorded against net deferred tax assets. The Company considered all of the available positive and negative evidence, including the significant operating losses incurred in 2006 and 2007, the continued operating

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losses in 2008, uncertainty as to the extent and timing of profitability in future periods, and ongoing tax planning strategies. Based on the weight of available evidence, the Company recorded a full valuation allowance against deferred tax assets during the quarter ended March 31, 2008. There were no significant changes in management s judgment during the quarter ended June 30, 2008 and the Company continues to carry a full valuation allowance.

If the realization of deferred tax assets in the future is considered more likely than not, a reduction to the valuation allowance related to the deferred tax assets would increase net income in the period such determination is made. The amount of the deferred tax asset considered realizable is based on significant estimates, and it is possible that changes in these estimates could materially affect the financial condition and results of operations. The Company s effective tax rate may vary from period to period based on changes in estimated taxable income or loss; changes to the valuation allowance; changes to federal or state tax laws; and as a result of acquisitions.

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

Overview

We design, manufacture and sell flat panel display systems, flight information computers and advanced monitoring systems to the military, government, commercial air transport and corporate aviation markets.

Our revenues are derived from the sale of our products to the retrofit market and to original equipment manufacturers (OEMs). Our customers include government and military entities and their commercial contractors, aircraft operators, aircraft modification centers and various OEMs. Although we occasionally sell our products directly to government entities, we primarily sell our products to commercial customers for end use in government and military programs. Sales to defense contractors are on commercial terms, although some of the termination and other provisions of government contracts are applicable to these contracts.

We continue to invest in and seek additional opportunities for our Flat Panel Display System product line. In October 2005, the FAA awarded the Company a second Technical Standard Order (TSO) for our flat panel display system COCKPIT/IP™. This TSO establishes our flat panel display system as meeting FAA requirements that have been put in place to ensure safe flight on a variety of aircraft types and, additionally, it addresses the most stringent Commercial Air Transport market requirements as provided in Title 14 of the Code of Federal Regulation, subpart 25, Commercial Air Transport. The TSO states It has been noted that this display system employs an integrity monitoring system that assures integrity to a catastrophic/Level A design condition with the use of commercial graphic processors.

In October 2005, the Company in a teaming arrangement with ABX Air received FAA Supplemental Type Certification (STC) of its Flat Panel Display System for use on B-767 aircraft. The STC provides B-767 operators with a low cost, rapidly implemented retrofit of their cockpit avionics with a modern pilot and copilot suite of high resolution multi-color LCD flat panel displays. Operators will benefit from improved dispatch reliability, logistics savings and adaptability to future requirements. The receipt of the STC positions the Company to pursue more than 1,700 B-757 and B-767 aircraft with similar needs for Flat Panel Display System upgrades. In January 2007, the Company in a teaming arrangement with ABX Air received another STC from the FAA on its Flat Panel Display System for use on B-757 aircraft. Similar to the prior STC, it provides B-757 operators with the same low cost, rapidly implemented retrofit of their cockpit avionics. The STC s also provide a foundation for incorporation into other airplanes as well.

Cost of sales related to product sales is comprised of product material purchased through our supplier base and direct in-house assembly labor and overhead costs. Many components used in assembling our products are standard, although certain parts are manufactured to meet our specifications. The overhead portion of cost of sales is primarily comprised of salaries and benefits, building occupancy, supplies, and outside service costs related to our production, purchasing, customer service, material control and quality departments as well as warranty costs.

Cost of sales related to Engineering-modification and development (EMD) is comprised of engineering labor, consulting services and other costs associated with specific design and development projects.

We intend to continue to invest in development of new products and enhancement of our existing product lines and will expense research and development costs as incurred.

Selling, general, and administrative expenses consist of marketing and business development expenses, professional expenses, salaries and benefits for executive and administrative personnel, facility costs, recruiting, legal, accounting, and other general corporate expenses.

The Company s financial statements contain certain deferred tax assets which have arisen primarily as a result of tax benefits associated with the loss before income tax incurred during the nine months ended June 30, 2008, as well as deferred income tax assets resulting from temporary differences in prior tax years. SFAS No. 109, *Accounting for Income Taxes (SFAS 109)*, requires the consideration of a valuation allowance to reflect the likelihood of realization of deferred tax assets. Significant management judgment is required in determining any valuation allowance recorded against net deferred tax assets. The Company considered all of the available positive and negative evidence, including the significant operating losses incurred in 2006 and 2007, the continued operating losses in 2008, uncertainty as to the extent and timing of profitability in future periods, and ongoing tax planning strategies. Based on the weight of available evidence, the Company recorded a full valuation allowance against deferred tax assets during the quarter ended March 31, 2008. There were no significant changes in management s judgment during the quarter ended June 30, 2008 and the Company continues to carry a full valuation allowance.

If the realization of deferred tax assets in the future is considered more likely than not, a reduction to the valuation allowance related to the deferred tax assets would increase net income in the period such determination is made. The amount of the deferred tax asset considered realizable is based on significant estimates, and it is possible that changes in these estimates could materially affect the financial condition and results of operations. The Company s effective tax rate may vary from period to period based on changes in

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estimated taxable income or loss; changes to the valuation allowance; changes to federal or state tax laws; and as a result of acquisitions.

Three Months Ended June 30, 2008 Compared to the Three Months Ended June 30, 2007

Net sales. Net sales increased $2.9 million, or 49%, to $8.8 million for the three months ended June 30, 2008 from $5.9 million in the three months ended June 30, 2007. For the three months ended June 30, 2008, product sales increased $3.2 million and EMD sales decreased $0.3 million from the same period in the prior year. The increase in product sales was primarily related to increased sales of Flat Panel Display System to a major customer.

Cost of sales. Cost of sales increased $1.0 million or 28%, to $4.6 million, or 52% of net sales in the three months ended June 30, 2008 from $3.6 million, or 61 % of net sales in the three months ended June 30, 2007. The overall dollar increase in cost of sales consists of $1.9 million in cost of sales related to product sales and a decrease of $0.9 million related to EMD sales. The $1.9 million increase in cost related to product sales is attributable to increased product sales. The decrease in cost related to EMD sales was primarily related to improved margins on the EMD sales.

Research and development. Research and development expense increased $2.1 million or 191% to $3.2 million or 36% of net sales in the three months ended June 30, 2008, from $1.1 million or 19% of net sales in the three months ended June 30, 2007.

The increase in research and development expense in the quarter was in part due to the reduction in the cost allocation associated with EMD cost of sales for the period. This allocation was necessary to match non- recurring engineering cost with corresponding non-recurring engineering sales in the period. Overall, when research and development expenses are combined with EMD cost of sales, total engineering, research and development related cost for the three months ended June 30, 2008 increased $1.2 million from the same period in the prior year and reflects the Company s continued commitment to product development, research and engineering.

Selling, general, and administrative. Selling, general and administrative expenses decreased $0.9 million, or 21%, to $3.3 million, or 38% of net sales in the three months ended June 30, 2008 from $4.2 million or 71% of net sales in the three months ended June 30, 2007. The decrease in the dollar amount of selling, general and administrative expenses for the three months ended June 30, 2008 from the same period in the prior year was primarily the result of a $1.3 million decrease in legal fees offset by $0.5 million increase for employee related expenses. The legal fees were largely incurred to protect the Company s intellectual property.

Asset impairment. The Company recorded an asset impairment of $2.5 million in the three months ended June 30, 2008. The impairment was related to previously acquired engineering software which is no longer part of the Company s product offering and will generate no future cash flows.

Interest income net. Interest income of $284,000 was partially offset by interest expense of $33,000 in the three months ended June 30, 2008. Interest income of $781,000 was partially offset by interest expense of $52,000 in the three months ended June 30, 2007. The decrease in interest income was primarily the result of reduced average cash balances and lower interest rates in the current quarter as opposed to the same period in the prior year.

Income tax expense (benefit). The Company recorded income tax benefits of $0.3 million and $1.0 million for the three months ended June 30, 2008 and 2007, respectively. The decrease in the amount of income tax benefit year over year is a direct result of the establishment of a valuation allowance. (See Note 13, Income Taxes) During the quarter ended June 30, 2008 the Company recognized a tax benefit of $256,000 primarily related to the unrecognized tax benefit previously recorded that as a result of examination are considered effectively settled.

The effective tax rate for the three months ended June 30, 2008 and 2007 was 6% and 43%, respectively. The difference in effective tax rates relates to the establishment of the full valuation allowance on deferred tax assets. (See Note 13. Income Taxes)

Net loss. As a result of the factors described above, our net loss in the three months ended June 30, 2008 was $4.3 million, an increase of $2.9 million from the net loss of $1.4 million for the three months ended June 30, 2007.

Nine months Ended June 30, 2008 Compared to the Nine months Ended June 30, 2007

Net sales. Net sales increased $7.1 million, or 54%, to $20.3 million for the nine months ended June 30, 2008 from $13.2 million in the nine months ended June 30, 2007. For the nine months ended June 30, 2008, product sales increased $7.0 million and EMD sales increased $0.1 million from the same period in the prior year. The increase in net sales was primarily related to increased Flat Panel Display Systems sales to a major customer.

Cost of sales. Cost of sales increased $3.3 million or 38%, to $12.0 million, or 59% of net sales in the nine months ended June 30, 2008 from $8.7 million, or 66 % of net sales in the nine months ended June 30, 2007. The overall dollar increase in cost of sales consists of $4.3 million in cost of sales related to product sales and a decrease of $1.0 million related to EMD sales. The increase of

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$4.3 million in cost related to product sales is attributable to increased product sales. The decrease of $1.0 million in cost related to EMD sales was primarily related to improved margins on the EMD sales.

Research and development. Research and development expenses increased $3.8 million or 97% to $7.7 million or 38% of net sales in the nine months ended June 30, 2008 from $3.9 million or 30% of net sales in the nine months ended June 30, 2007. The increase in research and development expense for the nine month period was primarily related to the increase in development requirements related to our Flat Panel Display System for new applications. Overall, when research and development expenses are combined with EMD cost of sales, total engineering, research and development related cost for the nine months ended June 30, 2008 increased $2.8 million from the same period in the prior year and reflects the Company s continued commitment to product development, research and engineering.

Selling, general, and administrative. Selling, general, and administrative expenses increased $2.9 million, or 26%, to $14.0 million, or 69% of net sales in the nine months ended June 30, 2008 from $11.1 million or 84% of net sales in the nine months ended June 30, 2007. The increase in the dollar amount of selling, general and administrative for the nine months ended June 30, 2008 from the same period in the prior year was primarily the result of an increase of $1.3 million in employee related expenses and an increase of $0.7 million of legal fees incurred in connection with litigation relating to the defense of our intellectual property.

Asset impairment. The Company recorded an asset impairment of $2.5 million in the nine months ended June 30, 2008. The impairment was related to previously acquired engineering software which is no longer part of the Company s product offering and will generate no future cash flows.

Interest income net. Interest income of $1.3 million was offset by interest expense of $0.1 million in the nine months ended June 30, 2008. Interest income of $2.4 million was offset by interest expense of $0.2 million in the nine months ended June 30, 2007. The decrease in net interest income was primarily the result of our reduced average cash balance and lower interest rates in the current period as opposed to the same period in the prior year.

Other income. In March 2008, the Company received a payment of $0.3 million in settlement of a claim against a shareholder for short swing profit liability to the Company pursuant to Section 16(b) of the Securities Exchange Act of 1934, as amended.

Income tax expense. The income tax expense for the nine months ended June 30, 2008 was $1.1 million as compared to an income tax benefit of $3.5 million for the nine months ended June 30, 2007. The increase in the amount of income tax expense was the result of the establishment of a valuation allowance related to the deferred tax assets the Company had accumulated on the balance sheet. As required by SFAS No. 109, this valuation allowance was recorded based on the weight of available positive and negative evidence, including two years of financial statement losses, its current projection of a pre-tax loss for the current year, and consideration of the Company s ongoing tax planning strategies. If the realization of deferred tax assets in the future is considered more likely than not, a reduction to the valuation allowance related to the deferred tax assets would increase net income in the period such determination is made.

The effective tax rate for the nine months ended June 30, 2008 and 2007 was 8% and 42%, respectively. The difference in the effective tax rates relates to recording of the full valuation allowance on the deferred tax assets. (See Note 13. Income Taxes)

In December of 2006, an additional two-year extension of the Research and Experimentation (R&E) Tax Credit was enacted into law. This retroactive extension is for amounts paid or incurred from January 1, 2006 to December 31, 2006. The entire impact of this retroactive extension has been recognized in the nine months ended June 30, 2007, as required by SFAS 109.

Net income (loss). As a result of the factors described above, our net loss in the nine months ended June 30, 2008 was $15.5 million, an increase of $10.7 million from net loss of $4.8 million for the nine months ended June 30, 2007.

Liquidity and Capital Resources

Our main source of liquidity has been cash flows generated in prior years. We require cash principally to finance inventory, accounts receivable and payroll.

Our cash used in operating activities was $7.5 million for the nine months ended June 30, 2008 as compared to $3.7 million for the nine months ended June 30, 2007. The increase of $3.8 million was due primarily to higher net loss ($10.7 million), decreased accounts payable ($4.8 million) and increased inventory ($0.5 million) which was partially offset by decreased prepaid expenses and other current assets ($8.7 million), asset impairment ($2.5 million) and decreased deferred tax benefit ($1.7 million).

Our cash used in investing activities was $534,000 for the nine months ended June 30, 2008 and primarily consisted of the purchase of production and laboratory test equipment. Cash used in investing activities was $3.1 million for the nine months ended June 30, 2007. This consisted of spending $2.5 million on licensing fees and $0.6 million for production and laboratory equipment.

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Net cash flow used in financing activities was $32,000 for the nine months ended June 30, 2008 as compared to net cash provided by financing activities of $638,000 in the nine months ended June 30, 2007. The primary use of cash for financing activities was attributable to our repurchase of 7,000 shares of our stock at a total cost of $57,000. In both periods the primary source of cash was from proceeds from the exercise of stock options.

The Company entered into a $4,335,000 loan agreement dated August 1, 2000 with the Chester County, Pennsylvania Industrial Development Authority. The purpose of the loan was to fund the construction of the Company s new office and manufacturing facility. The loan matures in 2015 and carries an interest rate set by the remarketing agent that is consistent with 30-day tax-exempt commercial paper. The loan agreement includes an optional redemption schedule that allows the Company the option of forgoing any principal pay-down of the outstanding balance and, accordingly, the balance of the notes payable will be due in 2015.

In November 2007, the Company and the lender signed an amendment to the loan agreement, which deleted existing financial covenants and replaced them with only one restrictive covenant that requires the Company to maintain at all times unencumbered cash and marketable securities having a market value of at least $20 million. The Company was in compliance with this covenant as of June 30, 2008.

Our future capital requirements depend on numerous factors, including market acceptance of our products, the timing and rate of expansion of our business, acquisitions, joint ventures and other factors. We have experienced increases in our expenditures since our inception consistent with growth in our operations, personnel and product line, and we anticipate that our expenditures will continue to increase in the foreseeable future. We believe that our cash and cash equivalents will provide sufficient capital to fund our operations for at least the next twelve months. However, we may need to raise additional funds through public or private financings or other arrangements in order to support more rapid expansion of our business than we now anticipate either through acquisitions or organic growth. Further, we may need to develop and introduce new or enhanced products, respond to competitive pressures, invest in or acquire businesses or technologies or respond to unanticipated requirements or developments. If additional funds are raised through the issuance of equity securities, dilution to existing shareholders may result. If insufficient funds are available, we may not be able to introduce new products or compete effectively in any of our markets, which could hurt our business.

Backlog

As of June 30, 2008 and 2007, our backlog was $71.4 million and $72.7 million, respectively. The Flat Panel Display System components of backlog were $64.9 million and $65.2 million as of June 30, 2008 and 2007, respectively.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. The Company s most critical accounting policies are revenue recognition, income taxes, inventory valuation, share-based compensation and warranty reserves.

Revenue recognition

The Company recognizes revenue under the provisions of Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* (SAB 104).

The Company enters into certain sales arrangements that include multiple deliverables as defined in Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21). The Company identifies all goods and/or services that are to be delivered separately under a sales arrangement and allocates revenue to each deliverable based on fair value. In general, revenues are separated between product sales and EMD sales. The allocated revenue for each deliverable is then recognized using appropriate revenue recognition methods.

The Company accounts for transactions with software that is more than incidental to the products under Statement of Position (SOP) 97-2, *Software Revenue Recognition* (SOP 97-2) and EITF Issue 03-5, *Applicability of AICPA Statement of Position 97-2, Software Revenue Recognition, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software* (EITF 03-5 *).* Accordingly, revenue is recognized when all of the following criteria are met: 1) there is persuasive evidence that an arrangement exists; 2) delivery has occurred or services have been rendered; 3) the seller s price to the buyer is fixed or determinable; and 4) collectibility is reasonably assured.

Sales related to certain long-term contracts requiring development and delivery of products over several accounting periods are accounted for under the American Institute of Certified Public Accountants (AICPA) SOP 81-1, *Accounting for Performance of*

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Construction-Type and Certain Production-Type Contracts (SOP 81-1). We consider the nature of these contracts as well as the types of products and services provided when determining the appropriate accounting treatment for a particular contract. Certain long-term contracts are recorded on a percentage of completion basis using cost-to-cost methodology to measure progress towards completion.

The Company offers its customers extended warranties for additional fees. These warranty sales are recorded as deferred revenue and recognized as sales on a straight-line basis over the warranty period.

Income taxes

Income taxes are recorded in accordance with SFAS No. 109. Provisions for federal and state income taxes are calculated on reported financial statement pre-tax income based on current tax law. The Company recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities and expected benefits of utilizing net operating loss carryforwards. The impact on deferred taxes of changes in tax rates and laws, if any, applied to the years during which temporary differences are expected to be settled, are reflected in the consolidated financial statements in the period of enactment.

A valuation allowance is recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. In evaluating our ability to recover our deferred tax assets we consider all available positive and negative evidence, including our operating results, ongoing tax planning, and forecasts of future taxable income. In the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of their net recorded amount, we would make an adjustment to the valuation allowance which would reduce the provision for income taxes.

Inventories

Inventories are written down for estimated obsolescence equal to the difference between the cost of inventory and the estimated net realizable value based upon assumptions about future market conditions. If actual future demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Share-based compensation

Effective October 1, 2005, the Company adopted the provisions of SFAS 123R, using the modified prospective approach and now accounts for share-based compensation applying the fair value method for expensing stock options. Accordingly, the adoption of SFAS 123R s fair value method results in compensation costs for the Company s 1998 Stock Option Plan.

Warranty reserves

We offer warranties on some products of various lengths. At the time of shipment, we establish a reserve for the estimated cost of warranties based on our best estimate of the amounts necessary to settle future and existing claims using historical data on products sold as of the balance sheet date. The length of the warranty period, the product s failure rates and the customer s usage affects warranty cost. If the actual cost of warranties differs from our estimated amounts, future results of operations could be adversely affected.

Business Segments

We operate in one principal business segment which designs, manufactures and sells flight information computers, flat panel displays and advanced monitoring systems to the military, government, commercial air transport and corporate aviation markets. We currently derive virtually all our net sales from the sale of this equipment. Almost all of the net sales, operating results and identifiable assets are in the United States.

New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; however, the application of this Statement may change current practice for some entities. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this pronouncement.

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FORWARD-LOOKING STATEMENTS

This Form 10-Q contains statements, which, to the extent that they are not recitations of historical fact, constitute forward-looking statements within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934. The words anticipate, believe, estimate, expect, intend, may, plan, outlook, would, should, guidance, potential, continue, project, forecast and similar expressions are inte forward-looking statements. Forward-looking statements are not guarantees of future performance and involve risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied by these statements. Numerous factors, including potentially the following factors, could affect the Company s forward-looking statements and actual performance:

- market acceptance of our COCKPIT/IP™ system or other planned products or product enhancements;
- difficulties in developing and producing our flat panel systems, or COCKPIT/IP™, or other planned products or product enhancements;
- continued market acceptance of our air data systems products;
- the ability to obtain future contracts and awards;
- the availability of government funding and customer requirements;
- our ability to gain regulatory approval of our products in a timely manner;
- delays in receiving components from third party suppliers;
- the competitive environment;
- the termination of programs or contracts for convenience by customers;

- failure to retain key personnel;
- new product offerings from competitors;
- potential future acquisitions;
- protection of intellectual property rights;
- our ability to service the international market and
- other factors disclosed from time to time in our filings with the Securities and Exchange Commission.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Form 10-Q. The Company does not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events, circumstances or changes in expectations after the date of this Form 10-Q, or to reflect the occurrence of unanticipated events. The forward-looking statements in this document are intended to be subject to the safe harbor protection provided by Sections 27A of the Securities Act and 21E of the Exchange Act.

For a discussion identifying some important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see the Company s Securities and Exchange Commission filings including, but not limited to, the discussions of Risk Factors contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

Investors should also be aware that while we do, from time to time, communicate with securities analysts, it is against our policy to disclose any material non-public information or other confidential commercial information. Accordingly, shareholders should not assume that we agree with any statement or report issued by an analyst irrespective of the content of the statement or report. Furthermore, we have a policy against issuing or confirming financial forecasts or projections issued by others. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not the responsibility of Innovative Solutions and Support, Inc.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company s operations are exposed to market risks primarily as a result of changes in interest rates. The Company does not use derivative financial instruments for speculative or trading purposes. The Company s exposure to market risk for changes in interest rates relates to its cash equivalents and an industrial revenue bond. The Company s cash equivalents consist of funds invested in money market accounts, which bear interest at a variable rate, while the industrial revenue bond carries an interest rate that is consistent with 30-day, tax-exempt commercial paper. As the interest rates are variable, and we do not engage in hedging activities, a change in interest rates earned on the cash equivalents or paid on the industrial revenue bond would impact interest income and expense along with cash flows, but would not impact the fair market value of the related underlying instruments.

Item 4. Controls and Procedures

(a) An evaluation was performed under the supervision and with the participation of the Company s management, including its Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of the Company s disclosure controls and procedures, as such term is defined under Rule 13a-15e under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of June 30, 2008. Based on that evaluation, the Company s management, including the CEO and CFO, concluded that the Company s disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported as specified in Securities and Exchange Commission rules and forms and that such information is accumulated and communicated to the Company s management, including the CEO and CFO, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) There were no changes in the Company s internal control over financial reporting identified in connection with the evaluation of such controls that occurred during the Company s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, we are at times subject to various legal proceedings. Except with respect to the fees incurred in connection with the matters described below, we do not believe that any of the current legal proceedings will have a material adverse effect on our results of operations or financial position.

On September 13, 2005 the Company filed a lawsuit in the United States District Court for the Western District of Tennessee against J2, Inc., a company founded and jointly owned by Joseph Cesar, a former employee of the Company, and James Zachary, a former sales consultant for the Company. The complaint alleged that the J2/Kollsman/Air Data Computer then being marketed by J2 and manufactured by Kollsman, Inc. infringed a patent assigned to the Company. After learning additional information regarding the activities of Caesar and Zachary during the development of the J2/Kollsman Air Data Computer, the Company added to its complaint claims of trade secret misappropriation, breach of contract and breach of fiduciary duty, based on the Company s belief that confidential and proprietary information, including trade secret information, had been used in the development and marketing of the J2/Kollsman Air Data Computer. On January 31, 2006, Kollsman, Inc., and Caesar and Zachary, as individuals, were added to the lawsuit as defendants.

On November 7, 2007, the Company received a favorable jury verdict in its trade secret misappropriation case against Kollsman, Inc. (a subsidiary of Elbit Systems Ltd.), J2 Inc., Joseph Caesar, James Zachary and Zachary Technologies, Inc. in the United States District Court for the Western District of Tennessee. The jury unanimously found that each of the defendants had misappropriated the Company s air data computer technology. The jury found that the Company had suffered damages of just over $4.4 million in lost profits and $1.6 million in defendants net profits, for a total of over $6 million. The jury also found in favor of the Company s claims for breach of duty and contract, and unfair competition against J2 Inc., Joseph Caesar, James Zachary and Zachary Technologies, Inc.

On December 18, 2007, the court entered a temporary injunction aimed at preventing further use of the Company s trade secret and proprietary information. On March 14, 2008, the judge presiding over the case heard the Company s claims for a permanent injunction as well as punitive and exemplary damages and attorneys fees against Kollsman and the other defendants**.** The Court also is considering post-judgment motions by which Kollsman, J2 and Caesar seek to overturn the verdict against them.

On July 7, 2008, the court issued several rulings in the case. In the rulings, the court awarded damages, interest and fees in addition to the more than $6 million in compensatory damages awarded by the jury when it rendered its verdict in the case in November 2007. The additional awards bring the damages assessed against Kollsman, Inc. to a total of more than $23 million. The court also entered an order granting our request for injunctive relief.

On January 17, 2007, the Company filed suit in Pennsylvania state court against Strathman Associates, a former software consultant for the Company, alleging that Strathman had improperly used the Company s trade secret and proprietary information in assisting J2 and Kollsman in developing the J2/Kollsman Air Data Computer. The case is ongoing.

For the nine months ended June 30, 2008 the Company has incurred approximately $5.4 million in legal fees in connection with the two matters discussed above compared to $4.5 million in the nine months ended June 30, 2007.

Item 1A. Risk Factors

There are no material changes to the risk factors described under Item 1A of our Form 10-K for the year ended September 30, 2007.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

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Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits

31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)
32.1	Certification Pursuant to U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

INNOVATIVE SOLUTIONS AND SUPPORT, INC.

Date: August 6, 2008	By:	/s/ JOHN C. LONG JOHN C. LONG CHIEF FINANCIAL OFFICER