

AeroVironment Inc
Form 10-Q
September 08, 2011
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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 July 30, 2011

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 Number: 001-33261

AEROVIRONMENT, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-2705790

(I.R.S. Employer Identification No.)

**181 W. Huntington Drive, Suite 202
Monrovia, California**

(Address of principal executive offices)

91016

(Zip Code)

(626) 357-9983

(Registrant's telephone number, including area code)

N/A

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

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of August 26, 2011, the number of shares outstanding of the registrant's common stock, \$0.0001 par value, was 21,094,491.

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****AeroVironment, Inc.****Consolidated Balance Sheets****(In thousands except share and per share data)**

	July 30, 2011 (Unaudited)	April 30, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 81,247	\$ 62,041
Short-term investments	106,883	126,839
Accounts receivable, net of allowance for doubtful accounts of \$969 at July 30, 2011 and \$639 at April 30, 2011	22,034	44,376
Unbilled receivables and retentions	13,399	21,966
Inventories, net	38,299	38,137
Income tax receivable	745	
Deferred income taxes	2,460	2,300
Prepaid expenses and other current assets	2,176	2,372
Total current assets	267,243	298,031
Long-term investments	6,154	6,275
Property and equipment, net	18,134	17,498
Deferred income taxes	9,760	9,762
Other assets	181	181
Total assets	\$ 301,472	\$ 331,747
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 12,549	\$ 31,134
Wages and related accruals	9,024	15,458
Income taxes payable		7,404
Other current liabilities	7,535	7,384
Liability for uncertain tax positions	724	724
Total current liabilities	29,832	62,104
Wages and other accruals	1,056	762
Deferred rent	1,245	1,275
Liability for uncertain tax positions	4,138	4,138
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		

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Issued and outstanding shares	22,094,291 at July 30, 2011 and 21,949,884 at April 30, 2011	2	2
Additional paid-in capital		121,170	119,765
Accumulated other comprehensive loss		(782)	(784)
Retained earnings		144,811	144,485
Total stockholders' equity		265,201	263,468
Total liabilities and stockholders' equity		\$ 301,472	\$ 331,747

See accompanying notes to consolidated financial statements (unaudited).

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

	Three Months Ended	
	July 30, 2011	July 31, 2010
Revenue:		
Product sales	\$ 29,299	\$ 12,220
Contract services	32,698	26,008
	61,997	38,228
Cost of sales:		
Product sales	17,872	8,686
Contract services	22,410	17,506
	40,282	26,192
Gross margin	21,715	12,036
Selling, general and administrative	13,700	11,371
Research and development	7,586	7,972
Income (loss) from operations	429	(7,307)
Other income:		
Interest income	78	121
Income (loss) before income taxes	507	(7,186)
Provision (benefit) for income taxes	181	(3,743)
Net income (loss)	\$ 326	\$ (3,443)
Earnings (loss) per share data:		
Basic	\$ 0.02	\$ (0.16)
Diluted	\$ 0.01	\$ (0.16)
Weighted average shares outstanding:		
Basic	21,724,053	21,545,870
Diluted	22,238,117	21,545,870

See accompanying notes to consolidated financial statements (unaudited).

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

	Three Months Ended	
	July 30, 2011	July 31, 2010
Operating activities		
Net income (loss)	\$ 326	\$ (3,443)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation and amortization	1,970	2,683
Provision for doubtful accounts	330	399
Deferred income taxes	(160)	(166)
Stock-based compensation	754	501
Tax benefit from exercise of stock options	376	109
Excess tax benefit from stock-based compensation	(80)	
Gain on sale of property and equipment		(60)
Changes in operating assets and liabilities:		
Accounts receivable	22,012	21,189
Unbilled receivables and retentions	8,567	2,876
Inventories	(162)	(7,157)
Income tax receivable	(745)	(2,743)
Other assets	196	(149)
Accounts payable	(18,585)	(8,438)
Other liabilities	(13,343)	(10,855)
Net cash provided by (used in) operating activities	1,456	(5,254)
Investing activities		
Acquisitions of property and equipment	(2,606)	(1,881)
Proceeds from the sale of property and equipment		83
Net sales of held-to-maturity investments	19,956	23,594
Net sales of available-for-sale investments	125	100
Net cash provided by investing activities	17,475	21,896
Financing activities		
Excess tax benefit from stock-based compensation	80	
Exercise of stock options	195	135
Net cash provided by financing activities	275	135
Net increase in cash and cash equivalents	19,206	16,777
Cash and cash equivalents at beginning of period	62,041	28,665
Cash and cash equivalents at end of period	\$ 81,247	\$ 45,442
Supplemental disclosure:		
Unrealized gains on long-term investments recorded in other comprehensive income (loss), net of deferred taxes of \$2 and \$9, respectively	\$ 2	\$ 14

See accompanying notes to consolidated financial statements (unaudited).

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AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

1. Organization and Significant Accounting Policies

Organization

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

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation with respect to the interim financial statements have been included. The results of operations for the three months ended July 30, 2011 are not necessarily indicative of the results for the full year ending April 30, 2012. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended April 30, 2011, included in AeroVironment, Inc.'s Annual Report on Form 10-K.

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

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

Segments

The Company's products are sold and divided among two reportable segments to reflect the Company's strategic goals. Operating segments are defined as components of an enterprise from which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker (CODM) in deciding how to allocate resources and in assessing performance. The Company's CODM is the Chief Executive Officer, who reviews the revenue and gross margin results for each of these segments in order to make resource allocation decisions, including

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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.

Investments

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

Fair Values of Financial Instruments

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

Government Contracts

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

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AeroVironment, Inc.

Notes to Consolidated Financial Statements (Unaudited)

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

Earnings (Loss) Per Share

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

The reconciliation of diluted to basic shares is as follows:

	Three Months Ended	
	July 30, 2011	July 31, 2010
Denominator for basic earnings (loss) per share:		
Weighted average common shares outstanding, excluding unvested restricted stock	21,724,053	21,545,870
Dilutive effect of employee stock options and unvested restricted stock	514,064	
Denominator for diluted earnings (loss) per share	22,238,117	21,545,870

During the three months ended July 30, 2011, certain shares reserved for issuance upon exercise of stock options and shares of unvested restricted stock were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive. The number of shares reserved for issuance upon exercise of stock options and shares of unvested restricted stock that met this anti-dilutive criterion was approximately 19,000 for the three months ended July 30, 2011. Due to the net loss for the three months ended July 31, 2010, no shares reserved for issuance upon exercise of stock options or shares of unvested restricted stock were included in the computation of diluted loss per share as their inclusion would have been anti-dilutive.

Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board (FASB) issued accounting guidance which requires companies to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new guidance eliminates the option to present the components of other comprehensive income as part of the statement of equity. The new guidance is effective for the Company's interim and

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annual reporting periods beginning on May 1, 2012 and will be applied retrospectively, with early adoption permitted. The Company does not expect the adoption of this new guidance to have a material impact on the Company's consolidated financial statements, other than the change in presentation described in the new guidance.

In May 2011, the FASB issued accounting guidance to provide a consistent definition of fair value and to ensure that the fair value measurement and disclosure requirements are similar between generally accepted accounting principles in the United States and International Financial Reporting Standards. The new guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. The new guidance is effective for the Company's interim and annual reporting periods beginning on May 1, 2012 and will be applied prospectively. The Company is currently evaluating the potential impact of this adoption on its consolidated financial statements.

2. Investments

Investments consist of the following (in thousands):

	July 30, 2011	April 30, 2011
	(In thousands)	
Short-term investments:		
Held-to-maturity securities:		
U.S. Treasury bills	\$ 106,883	\$ 126,839
Total short-term investments	\$ 106,883	\$ 126,839
Long-term investments:		
Available-for-sale securities:		
Auction rate securities	\$ 6,154	\$ 6,275
Total long-term investments	\$ 6,154	\$ 6,275

Table of Contents**AeroVironment, Inc.****Notes to Consolidated Financial Statements (Unaudited)****Held-To-Maturity Securities**

At July 30, 2011, the balance of held-to-maturity securities consisted of U.S. Treasury bills. Interest earned from these investments is recorded in interest income.

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of July 30, 2011, were as follows (in thousands):

	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
U.S. Treasury bills	\$ 106,883	\$	16	\$	(9)	\$	106,890
Total held-to-maturity investments	\$ 106,883	\$	16	\$	(9)	\$	106,890

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the held-to-maturity investments as of April 30, 2011, were as follows (in thousands):

	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
U.S. Treasury bills	\$ 126,839	\$	38	\$	(3)	\$	126,874
Total held-to-maturity investments	\$ 126,839	\$	38	\$	(3)	\$	126,874

The amortized cost and fair value of the Company's held-to-maturity securities by contractual maturity at July 30, 2011, were as follows (in thousands):

	Cost		Fair Value
Due within one year	\$ 106,883	\$	106,890
Total	\$ 106,883	\$	106,890

Available-For-Sale Securities

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As of July 30, 2011, the entire balance of available-for-sale securities consisted of four investment grade auction rate municipal bonds with maturities ranging from 8 to 23 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 July 30, 2011, 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 July 30, 2011. 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.

Based on the Company's ability to access its cash and cash equivalents, expected operating cash flows, and other sources of cash, the Company does not anticipate the current lack of liquidity of these investments will affect its ability to operate the business in the ordinary course. The Company believes the current lack of liquidity of these investments is temporary and expects that the securities will be redeemed or refinanced at some point in the future. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible other-than-temporary impairment. The auction rate securities have been in an unrealized loss position for more than 12 months. The Company has the ability and the intent to hold these investments until a recovery of fair value, which may be at maturity, and as of July 30, 2011, it did not consider these investments to be other-than-temporarily impaired.

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The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale investments as of July 30, 2011, were as follows (in thousands):

	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
Auction rate securities	\$ 7,450	\$		\$	(1,296)	\$	6,154
Total available-for-sale investments	\$ 7,450	\$		\$	(1,296)	\$	6,154

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the available-for-sale investments as of April 30, 2011, were as follows (in thousands):

	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
Auction rate securities	\$ 7,575	\$		\$	(1,300)	\$	6,275
Total available-for-sale investments	\$ 7,575	\$		\$	(1,300)	\$	6,275

The amortized cost and fair value of the Company's auction rate securities by contractual maturity at July 30, 2011, were as follows (in thousands):

	Cost		Fair Value
Due after five through 10 years	\$ 1,925	\$	1,722
Due after 10 years	5,525		4,432
Total	\$ 7,450	\$	6,154

3. Inventories, net

Inventories consist of the following (in thousands):

	July 30, 2011		April 30, 2011
Raw materials	\$ 11,350	\$	13,737

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Work in process		9,664		7,994
Finished goods		18,570		17,647
Inventories, gross		39,584		39,378
Reserve for inventory obsolescence		(1,285)		(1,241)
Inventories, net	\$	38,299	\$	38,137

4. Fair Value Measurements

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

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

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

The Company's financial assets measured at fair value on a recurring basis at July 30, 2011, were as follows (in thousands):

Description	Quoted prices in active markets for identical assets (Level 1)	Fair Value Measurement Using Significant		Total
		other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Auction rate securities	\$	\$	\$ 6,154	\$ 6,154
Total	\$	\$	\$ 6,154	\$ 6,154

Due to the auction failures of the Company's auction rate securities that began in the fourth quarter of fiscal 2008, there are still no quoted prices in active markets for identical assets as of July 30, 2011. Therefore, the Company has classified its auction rate securities as Level 3 financial assets. The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis in the table above that used significant unobservable inputs (Level 3) (in thousands):

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Securities
Balance at April 30, 2011	\$ 6,275
Transfers to Level 3	
Total gains (losses) (realized or unrealized) Included in earnings	
Included in other comprehensive income (loss)	4
Settlements	(125)
Balance at July 30, 2011	\$ 6,154
The amount of total gains or (losses) for the period included in earnings (or change in net assets) attributable to the change in unrealized gains or losses relating to assets still held at July 30, 2011	\$

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.

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

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at some point in the future, allowing the Company to recover the original cost of \$7.5 million. The Company will continue to monitor the value of its auction rate securities at each reporting period for a possible other-than-temporary impairment.

5. Other Comprehensive Income (Loss)

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

	Three Months Ended	
	July 30, 2011	July 31, 2010
Net income (loss)	\$ 326	\$ (3,443)
Other comprehensive income, net of tax:		
Unrealized gains on long-term investments	2	14
Comprehensive income (loss)	\$ 328	\$ (3,429)

Table of Contents**AeroVironment, Inc.****Notes to Consolidated Financial Statements (Unaudited)****6. Warranty Reserves**

The Company accrues an estimate of its exposure to warranty claims based upon both current and historical product sales data and warranty costs incurred. The warranty reserve is included in other current liabilities. The related expense is included in cost of sales. Warranty reserve activity is summarized as follows for the three months ended July 30, 2011 and July 31, 2010 (in thousands):

	Three Months Ended	
	July 30, 2011	July 31, 2010
Beginning balance	\$ 1,127	\$ 804
Warranty expense	352	216
Warranty costs incurred	(433)	(221)
Ending balance	\$ 1,046	\$ 799

7. Customer-Funded Research & Development

Customer-funded R&D costs are incurred pursuant to contracts (revenue arrangements) to perform R&D activities according to customer specifications. These costs are direct contract costs and are expensed to cost of sales when the corresponding revenue is recognized, which is generally as the R&D services are performed. Revenue from customer-funded R&D was approximately \$5.2 million and \$11.9 million for the three months ended July 30, 2011 and July 31, 2010, respectively.

8. Income Taxes

For the three months ended July 30, 2011 and July 31, 2010, the Company recorded a provision and (benefit) for income taxes of \$0.2 million and (\$3.7) million, respectively, yielding an effective tax rate of 35.7% and 52.1%, respectively. The variance from statutory rates for the three months ended July 31, 2010 was primarily due to a reduction in the liability for uncertain tax positions related to the conclusion of the examination of the Company's fiscal 2003 and 2004 tax returns. The examination concluded in May of 2010 and no change was required to the tax returns filed.

9. Segment Data

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The Company's product segments are as follows:

- **Unmanned Aircraft Systems (UAS)** The UAS segment focuses primarily on the design, development, production and support of innovative UAS that provide situational awareness and other mission effects to increase the security and operational effectiveness of the Company's customers.
- **Efficient Energy Systems (EES)** The EES segment focuses primarily on the design, development, production and support 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 limited financial statement information by segment.

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

The segment results are as follows (in thousands):

	Three Months Ended	
	July 30, 2011	July 31, 2010
Revenue:		
UAS	\$ 52,205	\$ 33,447
EES	9,792	4,781
Total	61,997	38,228
Gross margin:		
UAS	20,205	10,370
EES	1,510	1,666
Total	21,715	12,036
Selling, general and administrative	13,700	11,371
Research and development	7,586	7,972
Income (loss) from operations	429	(7,307)
Interest income	78	121
Income (loss) before income taxes	\$ 507	\$ (7,186)

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

This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. In some cases, forward-looking statements can be identified by words such as anticipates, believes, could, estimates, expects, intends, may, potential, predicts, projects, should, will, would or similar expressions. Such forward-looking statements are based on current expectations, estimates and projections about our industry, our management's beliefs and assumptions made by our management. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A, Risk Factors.

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

Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. When we prepare these consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Some of our accounting policies require that we make subjective judgments, including estimates that involve matters that are inherently uncertain. Our most critical estimates include those related to revenue recognition, inventories and reserves for excess and obsolescence, long-term investments, 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.

There have been no material changes made to the critical accounting estimates during the periods presented in the consolidated financial statements from those disclosed in the Form 10-K for the fiscal year ended April 30, 2011.

Fiscal Periods

Due to our fixed year end date of April 30, our first and fourth quarters each consist of approximately 13 weeks. The second and third quarters each consist of exactly 13 weeks. Our first three quarters end on a Saturday. Our 2012 fiscal year ends on April 30, 2012 and our fiscal quarters end on July 30, 2011, October 29, 2011 and January 28, 2012.

Results of Operations

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

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

Three Months Ended July 30, 2011 Compared to Three Months Ended July 31, 2010

	Three Months Ended	
	July 30, 2011	July 31, 2010
Revenue:		
UAS	\$ 52,205	\$ 33,447
EES	9,792	4,781
Total	61,997	38,228
Gross margin:		
UAS	20,205	10,370
EES	1,510	1,666
Total	21,715	12,036
Selling, general and administrative	13,700	11,371
Research and development	7,586	7,972
Income (loss) from operations	429	(7,307)
Interest income	78	121
Income (loss) before income taxes	\$ 507	\$ (7,186)

Revenue. Revenue for the three months ended July 30, 2011 was \$62.0 million, as compared to \$38.2 million for the three months ended July 31, 2010, representing an increase of \$23.8 million, or 62%. UAS revenue increased by \$18.8 million to \$52.2 million for the three months ended July 30, 2011, primarily due to an increase in UAS product deliveries of \$12.8 million and service revenue of \$12.3 million, partially offset by a decrease in customer-funded R&D work of \$6.3 million. The increase in UAS product deliveries and service revenue was primarily due to increased deliveries of digital Puma All Environment unmanned aircraft systems, or Puma AE systems, and services in support of Puma AE systems. The decrease in customer-funded R&D work was primarily due to decreased activity on the Global Observer program. EES revenue increased by \$5.0 million to \$9.8 million for the three months ended July 30, 2011. The increase in EES revenue was primarily due to increased product deliveries of electric vehicle test systems, industrial electric vehicle charging systems, and passenger electric vehicle charging docks.

Cost of Sales. Cost of sales for the three months ended July 30, 2011 was \$40.3 million, as compared to \$26.2 million for the three months ended July 31, 2010, representing an increase of \$14.1 million, or 54%. The increase in cost of sales was caused primarily by increases in UAS cost of sales of \$8.9 million and EES cost of sales of \$5.2 million due to increased revenue.

Gross Margin. Gross margin for the three months ended July 30, 2011 was \$21.7 million, as compared to \$12.0 million for the three months ended July 31, 2010, representing an increase of \$9.7 million, or 80%. UAS gross margin increased \$9.8 million, or 95%, to \$20.2 million for the three months ended July 30, 2011. As a percentage of revenue, gross margin for UAS increased from 31% to 39% primarily due to the higher portion of revenue associated with fixed-price contracts compared to cost-reimbursable contracts. EES gross margin decreased \$0.2 million, or 9%, to \$1.5 million for the three months ended July 30, 2011. As a percentage of revenue, EES gross margin decreased from 35% to 15% primarily due to higher than expected program costs on Department of Defense related development contracts and transition costs related to initial low-rate production of several new electric vehicle charging systems.

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Selling, General and Administrative. SG&A expense for the three months ended July 30, 2011 was \$13.7 million, or 22% of revenue, compared to SG&A expense of \$11.4 million, or 30% of revenue, for the three months ended July 31, 2010. SG&A expense increased \$2.3 million primarily due to higher marketing and business development costs and higher administrative infrastructure costs.

Research and Development. R&D expense for the three months ended July 30, 2011 was \$7.6 million, or 12% of revenue, compared to R&D expense of \$8.0 million, or 21% of revenue, for the three months ended July 31, 2010. R&D expense decreased \$0.4 million primarily due to lower investment in various UAS and EES technology development initiatives as they transitioned into production.

Interest Income. Interest income for the three months ended July 30, 2011 and July 31, 2010 remained unchanged at \$0.1 million.

Income Tax Expense. Our effective income tax expense rate was 35.7%, for the three months ended July 30, 2011, as compared to an income tax benefit rate of 52.1% for the three months ended July 31, 2010. The decrease in the tax rate was primarily due to a reduction in the liability for uncertain tax positions related to the conclusion of the examination of the Company's fiscal 2003 and 2004 tax returns that was recorded during the three months ended July 31, 2010, that resulted in a higher tax benefit rate. There was no such reduction in the liability for uncertain tax positions during the three months ended July 30, 2011.

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Backlog. We define funded backlog as unfilled firm orders for products and services for which funding currently is appropriated to us under the contract by the customer. As of July 30, 2011 and April 30, 2011, our funded backlog was approximately \$72.7 million and \$82.9 million, respectively.

In addition to our funded backlog, we also had unfunded backlog of \$192.6 million and \$230.8 million as of July 30, 2011 and April 30, 2011, respectively. We define unfunded backlog as the total remaining potential order amounts under cost reimbursable and fixed price contracts with multiple one-year options, and indefinite delivery indefinite quantity, or IDIQ, contracts. Unfunded backlog does not obligate the U.S. government to purchase goods or services. There can be no assurance that unfunded backlog will result in any orders in any particular period, if at all. Management believes that unfunded backlog does not provide a reliable measure of future estimated revenue under our contracts.

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

Liquidity and Capital Resources

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

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

Recent global market and economic conditions have been unprecedented and challenging with tighter credit conditions and recession in most major economies. As a result of these market conditions, the cost and availability of credit has been and may continue to be adversely affected

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by illiquid credit markets and wider credit spreads. Concern about the stability of the markets generally and the strength of counterparties specifically has led many lenders and institutional investors to reduce, and in some cases, cease to provide credit to businesses and consumers. These factors have led to a decrease in spending by businesses and consumers alike, and a corresponding decrease in global infrastructure spending. Continued turbulence in the U.S. and international markets and economies and prolonged declines in business and consumer spending may adversely affect our liquidity and financial condition, and the liquidity and financial condition of our customers, including our ability to access the capital markets to meet liquidity needs. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits. Given the current instability of financial institutions, we cannot be assured that we will not experience losses on these deposits.

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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 for the three months ended July 30, 2011 and July 31, 2010 (in thousands):

	Three Months Ended	
	July 30, 2011	July 31, 2010
	(Unaudited)	
Net cash provided by (used in) operating activities	\$ 1,456	\$ (5,254)
Net cash provided by investing activities	\$ 17,475	\$ 21,896
Net cash provided by financing activities	\$ 275	\$ 135

Cash Provided by Operating Activities. Net cash provided by operating activities for the three months ended July 30, 2011 increased by \$6.7 million to \$1.5 million, compared to net cash used in operating activities of \$5.2 million for the three months ended July 31, 2010. This increase in net cash provided by operating activities was primarily due to higher income of \$3.8 million and lower working capital needs of \$3.2 million.

Cash Provided by Investing Activities. Net cash provided by investing activities decreased by \$4.4 million to \$17.5 million for the three months ended July 30, 2011, compared to net cash provided by investing activities of \$21.9 million for the three months ended July 31, 2010. The decrease in net cash provided by investing activities was primarily due to lower net redemptions of investments of \$3.6 million and higher acquisitions of property and equipment of \$0.7 million.

Cash Provided by Financing Activities. Net cash provided by financing activities increased by \$0.2 million to \$0.3 million for the three months ended July 30, 2011, compared to \$0.1 million for the three months ended July 31, 2010. During the three months ended July 30, 2011, we received proceeds from stock option exercises of \$0.2 million.

Off-Balance Sheet Arrangements

During the first quarter, there were no material changes in our off-balance sheet arrangements or contractual obligations and commercial commitments from those disclosed in the Form 10-K for the fiscal year ended April 30, 2011.

Inflation

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

New Accounting Standards

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

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

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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, and do not expect to incur significant foreign exchange gains or losses in the future. We occasionally engage in forward contracts in foreign currencies to limit our exposure on non-U.S. dollar transactions.

ITEM 4. CONTROLS AND PROCEDURES

Controls and Procedures

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

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

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The subordinated indentures will define senior indebtedness to mean the principal of, premium, if any, and interest on:

- all indebtedness for money borrowed or guaranteed by us other than the subordinated debt securities, unless the indebtedness expressly states that it has the same rank as, or ranks junior to, the subordinated debt securities; and
- any deferrals, renewals or extensions of any senior indebtedness.

However, the term senior indebtedness will not include:

- any of our obligations to our Subsidiaries;
- any liability for Federal, state, local or other taxes owed or owing by us;
- any accounts payable or other liability to trade creditors, arising in the ordinary course of business, including guarantees of, or instruments evidencing, those liabilities;
- any indebtedness, guarantee or obligation of ours which is expressly subordinate or junior in right of payment in any respect to any other indebtedness, guarantee or obligation of ours, including any senior subordinated indebtedness and any subordinated obligations;
- any obligations with respect to any capital stock; or
- any indebtedness incurred in violation of the subordinated indenture.

There is no limitation on our ability to issue additional senior indebtedness. The senior debt securities constitute senior indebtedness under the subordinated indentures. The subordinated debt securities will rank equally with our other subordinated indebtedness.

Under the subordinated indentures, no payment may be made on the subordinated debt securities and no purchase, redemption or retirement of any subordinated debt securities may be made in the event:

- any senior indebtedness is not paid when due; or
- the maturity of any senior indebtedness is accelerated as a result of a default, unless the default has been cured or waived and the acceleration has been rescinded or that senior indebtedness has been paid in full.

We may, however, pay the subordinated debt securities without regard to the above restriction if the representatives of the holders of the applicable senior indebtedness approve the payment in writing to us and the trustee.

The representatives of the holders of senior indebtedness may notify us and the trustee in writing of a default, which can result in the acceleration of that senior indebtedness maturity without further notice or the expiration of any grace periods. In this event, we may not pay the subordinated debt securities for 179 days after receipt of that notice of such default unless the person who gave such notice gives written notice to the trustee and to us terminating the period of non-payment, the senior indebtedness is paid in full or the default that caused such notice is no longer continuing. If the holders of senior indebtedness or their representatives have not accelerated the maturity of the senior indebtedness at the end of the 179 day period, we may resume payments on the subordinated debt securities. Not more than one such notice may be given in any consecutive 360-day period, irrespective of the number of defaults with respect to senior indebtedness during that period.

In the event we pay or distribute our assets to creditors upon a total or partial liquidation or dissolution of us, or in bankruptcy or reorganization relating to us or our property, the holders of senior indebtedness will be entitled to receive payment in full of the senior indebtedness before the holders of subordinated debt securities are entitled to receive any payment of either principal or interest. Until the senior indebtedness is paid in full, any payment or distribution to which holders of subordinated debt securities would be entitled but for the subordination provisions of the subordinated indentures will be made to holders of the senior indebtedness.

If a distribution is made to holders of subordinated debt securities that, due to the subordination provisions, should not have been made to them, those holders of subordinated debt securities are required to hold it in trust for the holders of

senior indebtedness, and pay it over to them as their interests may appear.

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If payment of the subordinated debt securities is accelerated because of an event of default, either we or the trustee will promptly notify the holders of senior indebtedness or their representatives of the acceleration. We may not pay the subordinated debt securities until five business days after the holders of senior indebtedness or their representatives receive notice of the acceleration. Thereafter, we may pay the subordinated debt securities only if the subordination provisions of the subordinated indentures otherwise permit payment at that time.

As a result of the subordination provisions contained in the subordinated indentures, in the event of insolvency, our creditors who are holders of senior indebtedness may recover more, ratably, than the holders of subordinated debt securities. In addition, our creditors who are not holders of senior indebtedness may recover less, ratably, than holders of senior indebtedness and may recover more, ratably, than the holders of subordinated indebtedness. It is important to keep this in mind if you decide to hold our subordinated debt securities.

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DESCRIPTION OF THE PREFERRED STOCK

The following is a description of general terms and provisions of our preferred stock. The particular terms of any series of preferred stock will be described in the applicable prospectus supplement.

All the terms of the preferred stock are, or will be, contained in our Certificate of Incorporation and the certificate of designations relating to each series of the preferred stock, which will be filed with the SEC at or before the time we issue a series of the preferred stock.

We are authorized to issue up to 10,000,000 shares of preferred stock, par value \$1.00 per share. As of June 30, 2015, 4,178 shares of \$2 convertible preferred stock, liquidation preference \$50 per share, were outstanding. Our \$2 convertible preferred stock votes as a single class with our common stock, with each share entitled to a single vote. Subject to limitations prescribed by law, the board of directors is authorized at any time to:

- issue one or more series of preferred stock;
- determine the designation for any series by number, letter or title that shall distinguish the series from any other series of preferred stock; and
- determine the number of shares in any series.

The board of directors is authorized to determine, for each series of preferred stock, and the prospectus supplement will set forth with respect to the series the following information:

- whether dividends on that series of preferred stock will be cumulative and, if so, from which date;
- the dividend rate;
- the dividend payment date or dates;
- the liquidation preference per share of that series of preferred stock, if any;
- any conversion provisions applicable to that series of preferred stock;
- any redemption or sinking fund provisions applicable to that series of preferred stock;
- the voting rights of that series of preferred stock, if any; and
- the terms of any other preferences or special rights applicable to that series of preferred stock.

The preferred stock, when issued, will be fully paid and nonassessable.

Dividends

Holders of preferred stock will be entitled to receive, when, as and if declared by our board of directors, cash dividends at the rates and on the dates as set forth in the applicable certificate of designations. Generally, no dividends will be declared or paid on any series of preferred stock unless full dividends for all series of preferred stock, including any cumulative dividends still owing, have been or contemporaneously are declared and paid. When those dividends are not paid in full, dividends will be declared pro-rata so that the amount of dividends declared per share on each series of preferred stock will bear to each other series the same ratio that accrued dividends per share for each respective series of preferred stock bear to aggregate accrued dividends for all outstanding shares of preferred stock. In addition, generally, unless all dividends on the preferred stock have been paid, no dividends will be declared or paid on the common stock and we may not redeem or purchase any common stock.

Payment of dividends on any series of preferred stock may be restricted by loan agreements, indentures and other agreements governing certain transactions we may enter into.

Convertibility

No series of preferred stock will be convertible into, or exchangeable for, other securities or property except as set forth in the applicable certificate of designations.

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Redemption and Sinking Fund

No series of preferred stock will be redeemable or receive the benefit of a sinking fund except as set forth in the applicable certificate of designations.

Shares of preferred stock that we redeem or otherwise reacquire will resume the status of authorized and unissued shares of preferred stock undesignated as to series, and will be available for subsequent issuance. There are no restrictions on repurchase or redemption of the preferred stock while there is any arrearage on sinking fund installments except as may be set forth in the applicable certificate of designations.

Liquidation

In the event we voluntarily or involuntarily liquidate, dissolve or wind up our affairs, the holders of each series of preferred stock will be entitled to receive the liquidation preference per share specified in the prospectus supplement, plus any accrued and unpaid dividends. Holders of preferred stock will be entitled to receive these amounts before any distribution is made to the holders of common stock.

If the amounts payable to preferred stockholders are not paid in full, the holders of preferred stock will share ratably in any distribution of assets based upon the aggregate liquidation preference for all outstanding shares for each series. After the holders of shares of preferred stock are paid in full, they will have no right or claim to any of our remaining assets.

Neither the par value nor the liquidation preference is indicative of the price at which the preferred stock will actually trade on or after the date of issuance.

Voting

The holders of preferred stock will not be entitled to vote with the holders of common stock in the election of directors, except as provided in the certificate of designations with respect to a particular series. However, if and whenever accrued dividends on the preferred stock have not been paid or declared and a sum sufficient for the payment thereof set aside, in an amount equivalent to six quarterly dividends on all shares of all series of preferred stock at the time outstanding, then the holders of the preferred stock, voting separately as a class, will be entitled to elect two directors at the next annual or special meeting of the stockholders. During the time the holders of preferred stock are entitled to elect two additional directors, they are not entitled to vote with the holders of common stock in the election of any other directors. If all accumulated dividends on preferred stock have been paid in full, the holders of shares of preferred stock will no longer have the right to vote on directors except as provided for in the applicable certificate of designations, the term of office of each director so elected will terminate, and the number of our directors will, without further action, be reduced accordingly.

The vote of the holders of at least two-thirds of the outstanding shares of preferred stock voting only as a class is required to authorize any amendment to our Certificate of Incorporation or bylaws which would materially alter any existing provisions of the preferred stock or which would authorize a class of preferred stock ranking prior to the outstanding preferred stock as to dividends or assets. In addition, the vote of the holders of at least a majority of the outstanding shares of preferred stock voting together as a class is required to authorize any amendment to our Certificate of Incorporation authorizing the issuance of or any increase in the authorized amount of any class of preferred stock ranking on a parity with or increasing the number of authorized shares of preferred stock.

No Other Rights

The shares of a series of preferred stock will not have any preemptive rights, preferences, voting powers or relative, participating, optional or other special rights except as set forth above or in the prospectus supplement, the Certificate of Incorporation or certificate of designations or as otherwise required by law.

Transfer Agent and Registrar

We will designate the transfer agent for each series of preferred stock in the prospectus supplement.

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DESCRIPTION OF THE DEPOSITARY SHARES

We may, at our option, elect to offer fractional shares of preferred stock, rather than full shares of preferred stock. If we do, we will issue receipts for depositary shares, and each of these depositary shares will represent a fraction of a share of a particular series of preferred stock. Each owner of a depositary share will be entitled, in proportion to the applicable fractional interest in shares of preferred stock underlying that depositary share, to all rights and preferences of the preferred stock underlying that depositary share. Those rights include dividend, voting, redemption and liquidation rights.

The shares of preferred stock underlying the depositary shares will be deposited with a depositary under a deposit agreement between us, the depositary and the holders of the depositary receipts evidencing the depositary shares. The depositary will be a bank or trust company selected by us. The depositary will also act as the transfer agent, registrar and dividend disbursing agent for the depositary shares.

Holders of depositary receipts agree to be bound by the deposit agreement, which requires holders to take certain actions such as filing proof of residence and paying certain charges.

The following is a summary of the most important terms of the depositary shares. The deposit agreement, our Certificate of Incorporation and the certificate of designations for the applicable series of preferred stock that are, or will be, filed with the SEC will set forth all of the terms relating to the depositary shares.

Dividends

The depositary will distribute all cash dividends or other cash distributions received relating to the series of preferred stock underlying the depositary shares, to the record holders of depositary receipts in proportion to the number of depositary shares owned by those holders on the relevant record date. The record date for the depositary shares will be the same date as the record date for the preferred stock.

In the event of a distribution other than in cash, the depositary will distribute property received by it to the record holders of depositary receipts that are entitled to receive the distribution. However, if the depositary determines that it is not feasible to make the distribution, the depositary may, with our approval, adopt another method for the distribution. The method may include selling the property and distributing the net proceeds to the holders.

Liquidation Preference

In the event of our voluntary or involuntary liquidation, dissolution or winding up, the holders of each depositary share will be entitled to receive the fraction of the liquidation preference accorded each share of the applicable series of preferred stock, as set forth in the applicable prospectus supplement.

Redemption

If a series of preferred stock underlying the depositary shares is subject to redemption, the depositary shares will be redeemed from the proceeds received by the depositary resulting from the redemption, in whole or in part, of preferred stock held by the depositary. Whenever we redeem any preferred stock held by the depositary, the depositary will redeem, as of the same redemption date, the number of depositary shares representing the preferred stock so redeemed. The depositary will mail the notice of redemption to the record holders of the depositary receipts promptly upon receiving the notice from us and not less than 35 nor more than 60 days prior to the date fixed for redemption of the preferred stock and the depositary shares. The redemption price per depositary share will be equal to the applicable fraction of the redemption price payable per share for the applicable series of preferred stock. If fewer than all the

depository shares are redeemed, the depository shares will be selected by lot or ratably as the depository will decide.

Voting

Upon receipt of notice of any meeting at which the holders of preferred stock are entitled to vote, the depository will mail the information contained in the notice of meeting to the record holders of the depository receipts representing the preferred stock. Each record holder of those depository receipts on the record date will be entitled to instruct the depository as to the exercise of the voting rights pertaining to the amount of preferred stock underlying that holder's depository shares. The record date for the depository shares will be the same date

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as the record date for the preferred stock. The depositary will try, as far as practicable, to vote the preferred stock underlying the depositary shares in a manner consistent with the instructions of the holders of the depositary receipts. We will agree to take all action which may be deemed necessary by the depositary in order to enable the depositary to do so. The depositary will not vote the preferred stock to the extent that it does not receive specific instructions from the holders of depositary receipts.

Withdrawal of Preferred Stock

Owners of depositary shares are entitled, upon surrender of depositary receipts at the principal office of the depositary and payment of any unpaid amount due the depositary, to receive the number of whole shares of preferred stock underlying the depositary shares. Partial shares of preferred stock will not be issued. These holders of preferred stock will not be entitled to deposit the shares under the deposit agreement or to receive depositary receipts evidencing depositary shares for the preferred stock.

Amendment and Termination of Deposit Agreement

The form of depositary receipt evidencing the depositary shares and any provision of the deposit agreement may be amended at any time and from time to time by agreement between us and the depositary. However, any amendment which materially and adversely alters the rights of the holders of depositary shares, other than any change in fees, will not be effective unless the amendment has been approved by at least a majority of the depositary shares then outstanding. The deposit agreement automatically terminates if:

- all outstanding depositary shares have been redeemed; or
- there has been a final distribution relating to the preferred stock in connection with our dissolution, and that distribution has been made to all the holders of depositary shares.

Charges of Depositary

We will pay all transfer and other taxes and governmental charges arising solely from the existence of the depositary arrangements. We will also pay charges of the depositary in connection with the initial deposit of the preferred stock and the initial issuance of the depositary shares, any redemption of the preferred stock and all withdrawals of preferred stock by owners of depositary shares. Holders of depositary receipts will pay transfer, income and other taxes and governmental charges and certain other charges as provided in the deposit agreement. In certain circumstances, the depositary may refuse to transfer depositary shares, withhold dividends and distributions, and sell the depositary shares evidenced by the depositary receipt, if the charges are not paid.

Reports to Holders

The depositary will forward to the holders of depositary receipts all reports and communications we deliver to the depositary that we are required to furnish to the holders of the preferred stock. In addition, the depositary will make available for inspection by holders of depositary receipts at the principal office of the depositary—and at other places as it thinks is advisable—any reports and communications we deliver to the depositary as the holder of preferred stock.

Liability and Legal Proceedings

Neither we nor the depositary will be liable if either of us is prevented or delayed by law or any circumstance beyond our control in performing our obligations under the deposit agreement. Our obligations and those of the depositary will be limited to performance in good faith of our duties under the deposit agreement. Neither we nor the depositary will be obligated to prosecute or defend any legal proceeding in respect of any depositary shares or preferred stock unless satisfactory indemnity is furnished. We and the depositary may rely on written advice of counsel or

accountants, on information provided by holders of depositary receipts or other persons believed in good faith to be competent to give such information and on documents believed to be genuine and to have been signed or presented by the proper persons.

Resignation and Removal of Depositary

The depositary may resign at any time by delivering a notice to us of its election to do so. We may also remove the depositary at any time. Any such resignation or removal will take effect upon the appointment of a

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successor depositary and its acceptance of such appointment. The successor depositary must be appointed within 60 days after delivery of the notice for resignation or removal. In addition, the successor depositary must be a bank or trust company having its principal office in the United States of America and must have a combined capital and surplus of at least \$150,000,000.

Federal Income Tax Consequences

Owners of the depositary shares will be treated for Federal income tax purposes as if they were owners of the preferred stock underlying the depositary shares. Accordingly, the owners will be entitled to take into account for Federal income tax purposes income and deductions to which they would be entitled if they were holders of the preferred stock. In addition:

- no gain or loss will be recognized for Federal income tax purposes upon the withdrawal of preferred stock in exchange for depositary shares;
- the tax basis of each share of preferred stock to an exchanging owner of depositary shares will, upon the exchange, be the same as the aggregate tax basis of the depositary shares exchanged; and
- the holding period for preferred stock in the hands of an exchanging owner of depositary shares will include the period during which the person owned the depositary shares.

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DESCRIPTION OF THE COMMON STOCK

As of the date of this prospectus, we are authorized to issue up to 4.5 billion shares of common stock, \$0.10 par value per share. As of June 30, 2015, approximately 1.7 billion shares of common stock were outstanding. The common stock is listed on the New York Stock Exchange under the symbol **BMV**.

Dividends

Holders of common stock are entitled to receive dividends out of any assets legally available for payment of dividends as may from time to time be declared by our board of directors, subject to the rights of the holders of the preferred stock.

Voting

Each holder of common stock is entitled to one vote per share on all matters requiring a vote of the stockholders, including, without limitation, the election of directors. The holders of common stock do not have cumulative voting rights.

Rights upon Liquidation

In the event of our voluntary or involuntary liquidation, dissolution, or winding up, the holders of common stock will be entitled to share equally in our assets available for distribution after payment in full of all debts and after the holders of preferred stock have received their liquidation preferences in full.

Board of Directors

Our bylaws provide that our board of directors shall be a single class, elected annually at any meeting for the election of directors at which a quorum is present (a quorum being a majority of the stockholders), pursuant to a majority of the votes cast in uncontested elections. A majority of the votes cast means that the number of shares voted for a director must exceed the number of votes cast against that director. In contested elections where the number of nominees exceeds the number of directors to be elected, the vote standard is a plurality of votes cast. Our bylaws also provide that if a director nominee who currently serves as a director is not elected by a majority vote in an uncontested election, the director shall offer to tender his or her resignation to the board of directors.

Miscellaneous

Shares of common stock are not redeemable and have no subscription, conversion or preemptive rights.

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DESCRIPTION OF THE WARRANTS

We may issue warrants for the purchase of debt securities, preferred stock or common stock. Warrants may be issued independently or together with our debt securities, preferred stock or common stock and may be attached to or separate from any offered securities. Each series of warrants will be issued under a separate warrant agreement to be entered into between us and a bank or trust company, as warrant agent. The warrant agent will act solely as our agent in connection with the warrants and will not have any obligation or relationship of agency or trust for or with any holders or beneficial owners of warrants. A copy of the warrant agreement will be filed with the SEC in connection with any offering of warrants.

The prospectus supplement relating to a particular issue of warrants to issue debt securities, preferred stock or common stock will describe the terms of those warrants, including the following:

- the title of the warrants;
- the offering price for the warrants, if any;
- the aggregate number of the warrants;
- the designation and terms of the debt securities, preferred stock or common stock that may be purchased upon exercise of the warrants;
- if applicable, the designation and terms of the securities that the warrants are issued with and the number of warrants issued with each security;
- if applicable, the date from and after which the warrants and any securities issued with them will be separately transferable;
- the principal amount of debt securities that may be purchased upon exercise of a warrant and the price at which the debt securities may be purchased upon exercise;
- the number of shares of preferred stock or common stock that may be purchased upon exercise of a warrant and the price at which the shares may be purchased upon exercise;
- the dates on which the right to exercise the warrants will commence and expire;
- if applicable, the minimum or maximum amount of the warrants that may be exercised at any one time;
- whether the warrants represented by the warrant certificates or debt securities that may be issued upon exercise of the warrants will be issued in registered or bearer form;
- information relating to book-entry procedures, if any;
- the currency or currency units in which the offering price, if any, and the exercise price are payable;
- if applicable, a discussion of material United States federal income tax considerations;
- anti-dilution provisions of the warrants, if any;
- redemption or call provisions, if any, applicable to the warrants;
- any additional terms of the warrants, including terms, procedures and limitations relating to the exchange and exercise of the warrants; and
- any other information we think is important about the warrants.

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PLAN OF DISTRIBUTION

General

We may offer and sell securities in one or more transactions from time to time to or through underwriters, who may act as principals or agents, directly to other purchasers or through agents to other purchasers or through any combination of these methods.

A prospectus supplement relating to a particular offering of securities may include the following information:

- the terms of the offering;
- the names of any underwriters or agents;
- the purchase price of the securities;
- the net proceeds to us from the sale of the securities;
- any delayed delivery arrangements;
- any underwriting discounts and other items constituting underwriters' compensation;
- any initial public offering price; and
- any discounts or concessions allowed or reallocated or paid to dealers.

The distribution of the securities may be effected from time to time in one or more transactions at a fixed price or prices, which may be changed, at market prices prevailing at the time of sale, at prices related to prevailing market prices or at negotiated prices in block trades, or in underwritten offerings or in other types of trades.

Underwriting Compensation

We may offer these securities to the public through underwriting syndicates represented by a managing underwriter or managing underwriters or through an underwriter or underwriters without an underwriting syndicate. If underwriters are used for the sale of securities, the securities will be acquired by the underwriters for their own account. The underwriters may resell the securities in one or more transactions, including in negotiated transactions at a fixed public offering price or at varying prices determined at the time of sale. In connection with any such underwritten sale of securities, underwriters may receive compensation from us or from purchasers for whom they may act as agents, in the form of discounts, concessions or commissions. Underwriters may sell securities to or through dealers, and the dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters and/or commissions from the purchasers for whom they may act as agents.

If we use an underwriter or underwriters in the sale of particular securities, we will execute an underwriting agreement with those underwriters at the time of sale of those securities. The names of the underwriters will be set forth in the prospectus supplement used by the underwriters to sell those securities. Unless otherwise indicated in the prospectus supplement relating to a particular offering of securities, the obligations of the underwriters to purchase the securities will be subject to customary conditions precedent and the underwriters will be obligated to purchase all of the securities offered if any of the securities are purchased.

Underwriters, dealers and agents that participate in the distribution of securities may be deemed to be underwriters under the Securities Act of 1933, as amended (the "Securities Act"). Any discounts or commissions that they receive from us and any profit that they receive on the resale of securities may be deemed to be underwriting discounts and commissions under the Securities Act. If any entity is deemed an underwriter or any amounts deemed underwriting discounts and commissions, the prospectus supplement will identify the underwriter or agent and describe the compensation received from us.

Indemnification

We may enter agreements under which underwriters and agents who participate in the distribution of securities may be entitled to indemnification by us against various liabilities, including liabilities under the Securities Act, and to contribution with respect to payments which the underwriters, dealers or agents may be required to make.

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Related Transactions

Various of the underwriters who participate in the distribution of securities, and their affiliates, may perform various commercial banking and investment banking services for us from time to time in the ordinary course of business.

Delayed Delivery Contracts

We may authorize underwriters or other persons acting as our agents to solicit offers by institutions to purchase securities from us pursuant to contracts providing for payment and delivery on a future date. These institutions may include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others, but in all cases we must approve these institutions. The obligations of any purchaser under any of these contracts will be subject to the condition that the purchase of the securities shall not at the time of delivery be prohibited under the laws of the jurisdiction to which such purchaser is subject. The underwriters and other agents will not have any responsibility in respect of the validity or performance of these contracts.

Price Stabilization and Short Positions

If underwriters or dealers are used in the sale, until the distribution of the securities is completed, rules of the SEC may limit the ability of any underwriters to bid for and purchase the securities. As an exception to these rules, representatives of any underwriters are permitted to engage in transactions that stabilize the price of the securities. These transactions may consist of bids or purchases for the purpose of pegging, fixing or maintaining the price of the securities. If the underwriters create a short position in the securities in connection with the offering (that is, if they sell more securities than are set forth on the cover page of the prospectus supplement), the representatives of the underwriters may reduce that short position by purchasing securities in the open market.

We make no representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the securities. In addition, we make no representation that the representatives of any underwriters will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

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LEGAL MATTERS

The validity of the securities will be passed upon for us by Covington & Burling LLP, New York, New York. Any underwriters will be advised about other issues relating to any offering by their own legal counsel.

EXPERTS

The consolidated financial statements incorporated in this prospectus by reference from the Company's Annual Report on Form 10-K, and the effectiveness of the Company's internal control over financial reporting have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their reports, which are incorporated herein by reference. Such consolidated financial statements have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

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WHERE YOU CAN FIND MORE INFORMATION; DOCUMENTS INCORPORATED BY REFERENCE

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our SEC filings also are available over the Internet at the SEC's website at <http://www.sec.gov>.

The SEC allows us to incorporate by reference into this prospectus the information we file with it. This means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus, and later information that we file with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below and any future filings made with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Exchange Act until our offering is completed:

- Annual Report on Form 10-K for the year ended December 31, 2014, including the information in our proxy statement that is part of our Schedule 14A filed with the SEC on March 24, 2015 that is incorporated by reference in that Annual Report on Form 10-K;
- Quarterly Report on Form 10-Q for the quarter ended March 31, 2015;
- Quarterly Report on Form 10-Q for the quarter ended June 30, 2015; and
- Current Reports on Form 8-K or Form 8-K/A, filed on January 23, 2015, February 27, 2015, March 6, 2015, April 10, 2015, April 16, 2015, April 20, 2015, May 5, 2015 and May 8, 2015.

Furthermore, all filings we make with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the initial filing of this prospectus and prior to the termination of this offering (other than portions of these documents deemed to be furnished or not deemed to be filed, including the portions of these documents that are either (1) described in paragraphs (d)(1), (d)(2), (d)(3) or (e)(5) of Item 407 of Regulation S-K promulgated by the SEC or (2) furnished under Item 2.02 or Item 7.01 of a Current Report on Form 8-K, including any exhibits included with such Items) shall be deemed to be incorporated by reference into this prospectus.

We encourage you to read our periodic and current reports, as we think these reports provide additional information about our company which prudent investors find important. We make available free of charge most of our SEC filings through our Internet website (www.bms.com) as soon as reasonably practical after they are filed with the SEC. The information contained on our website is not a part of this prospectus. You may access these SEC filings on our website. You also may request a copy of these filings at no cost, by writing to or telephoning us at:

Bristol-Myers Squibb Company
345 Park Avenue
New York, New York 10154
Attention: Office of the Corporate Secretary
Telephone: (212) 546-4000

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\$

\$ % Notes due 2019

\$ % Notes due 2027

PRELIMINARY PROSPECTUS SUPPLEMENT

Joint Book-Running Managers

Goldman, Sachs & Co.

Morgan Stanley

BofA Merrill Lynch

Citigroup

J.P. Morgan

, 2017