## AeroVironment, Inc.

**BUSINESS:** AeroVironment, Inc. engages in the design, development, and production of unmanned aircraft systems and energy technologies for various industries and governmental agencies. It offers small unmanned aircraft systems (UAS) primarily to the U.S. D.O.D., and sells its fast charge systems for electric industrial vehicles battery to commercial consumers. Its small UAS, including CybAero, are also used by companies in the oil and gas production, defense, and law enforcement industries.

**Earnings Announcement:** Following the earnings announcement, the stock shot up and is trading just under where it was three months ago. It appears that investors are optimistic about AeroVironment’s prospects, which have raised the company’s share price. However, spending will probably have a material impact on earnings, so there is some risk to the stock. We think R&D expenses will climb higher as the company invests in new development programs. This will likely limit margin expansion, and landing UAS. This deal, which gives AeroVironment exclusive rights to provide CybAero’s systems to U.S. clients and government customers in NATO and other countries, helps to broaden AVAV’s product line up in the heavier, larger, longer-endurance UAS. In addition, an increasing rollout of electric charging stations in North America ought to boost revenues in the EES segment.

**We have raised our fiscal 2012 bottom-line estimate for AeroVironment by a nickel, to $1.50 a share (year ends April 30, 2013).** Although revenues were relatively flat in the October quarter, we expect business to pick up in the second half of the year. Specifically, we believe that orders for the company’s unmanned aircraft systems (UAS), such as the Puma AE and Raven, will be pushed back to later quarters. Meanwhile, ongoing demand for industrial fast charge systems ought to boost results at the Efficient Energy Systems (EES) division.

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The view on the Street has grown more favorable. Following the earnings announcement, the stock shot up and is trading just under where it was three months ago. It appears that investors are optimistic about AeroVironment’s prospects over the coming quarters. What’s more, we have raised the company’s share price on the equity one notch, to 3 (Average) levels. Share-net gains of around 10% are in the cards for fiscal 2013. AeroVironment recently formed a strategic partnership with Sweden-based CybAero to develop and distribute a Tier II vertical takeoff and landing UAS. This deal, which gives AeroVironment exclusive rights to provide CybAero’s systems to U.S. clients and government customers in NATO and other countries, helps to broaden AVAV’s product line up in the heavier, larger, longer-endurance UAS. In addition, an increasing rollout of electric charging stations in North America ought to boost revenues in the EES segment.

**There are some notable risks.** First, we think R&D expenses will climb higher as the company invests in new development programs. This will likely limit margin expansion. Second, the competitive playing field is tight, with a number of large rivals, such as General Atomics, Boeing, and Lockheed Martin. Smaller companies are also trying to widen their offerings and capture a greater share of this fast-growing sector. Lastly, cutbacks in defense spending will probably have a material impact on earnings.

### Long-term accounts may want to apply here. Even with the recent jump in price, the stock still offers wide appreciation potential out to 2015–2017.

Randy Shrick
December 14, 2012

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