INNOVATIVE SOLUTIONS & SUPPORT INC
Form 10-K
December 15, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 2014

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. 000-31157

INNOVATIVE SOLUTIONS AND SUPPORT, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania	**23-2507402**
(State or other jurisdiction of incorporation)	(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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	**Name of each exchange on which registered**
Common Stock par value $.001 per share	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes o No x

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or section 15(d) of the Exchange Act from their obligations under those sections.

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 o No x

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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, non-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	Smaller Reporting Company o

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

The aggregate market value of the Registrant s common stock held by non-affiliates of the Registrant as of March 31, 2014 (the last business day of the registrant s most recently completed second quarter) was approximately $79.6 million. Shares of common stock held by each executive officer and director and by each person who owns 10% or more of the Registrant s outstanding common stock have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of November 28, 2014, there were 16,957,642 outstanding shares of the Registrant s Common Stock

Documents Incorporated by Reference

Portions of the Registrant s Proxy Statement for the 2014 Annual Meeting of Shareholders to be filed prior to January 27, 2015 are incorporated by reference into Part III of this Report. Such Proxy Statement, except for the parts therein which have been specifically incorporated by reference, shall not be deemed filed for the purposes of this Report on Form 10-K.

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INNOVATIVE SOLUTIONS AND SUPPORT, INC.

2014 Annual Report on Form 10-K

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FORWARD LOOKING STATEMENTS

This report contains forward looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These forward looking statements are based largely on current expectations and projections about future events and trends affecting the business, are not guarantees of future performance, and involve a number of risks, uncertainties and assumptions that are difficult to predict. In this report, the words anticipates, believes, may, will, estimates, continues, anticipates, intends, forecasts, expects, plans, could, should, would, is likely and similar expressions, as they relate to the business or to its management, are intended to identify forward looking statements, but they are not exclusive means of identifying them. Unless the context otherwise requires, all references herein to IS&S, the Registrant, the Company, we, us or our are to Innovative Solutions and Support, Inc. and its consolidated subsidiaries.

The forward looking statements in this report are only predictions, and actual events or results may differ materially. In evaluating such statements, a number of risks, uncertainties and other factors could cause actual results, performance, financial condition, cash flows, prospects and opportunities to differ materially from those expressed in, or implied by, the forward looking statements. These risks, uncertainties and other factors include those set forth in Item 1A (Risk Factors) of this Annual Report on Form 10-K and the following factors:

- *the availability of government funding;*
- *the impact of general economic trends on the Company s business;*
- *the deferral or termination of programs or contracts for convenience by customers;*
- *difficulties in developing and producing the Company s COCKPIT/IP® Flat Panel Display System or other planned products or product enhancements;*
- *market acceptance of the Company s flat panel display systems, or COCKPIT/IP® or other planned products or product enhancements;*
- *continued market acceptance of the Company s air data systems and products;*
- *the ability to gain regulatory approval of products in a timely manner;*
- *delays in receiving components from third party suppliers;*
- *the competitive environment and new product offerings from competitors;*
- *the bankruptcy or insolvency of one or more key customers;*
- *protection of intellectual property rights;*
- *failure to retain/recruit key personnel;*
- *a cyber security incident;*

- *the ability to service the international market;*

- *potential future acquisitions; and*

- *other factors disclosed from time to time in the Company s filings with the United States Securities and Exchange Commission (the SEC).*

Except as expressly required by the federal securities laws, the Company undertakes no obligation to publicly update or revise any forward looking statements, whether as a result of new information, future events, or otherwise after the date of this report. Results of operations in any past period should not be considered indicative of the results to be expected for future periods. Fluctuations in operating results may result in fluctuations in the price of the Company s common stock.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. 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 Annual Report on Form 10-K, 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 of 1933, as amended (the Securities Act), and 21E of the Exchange Act.

Investors should also be aware that while the Company, from time to time, communicates with securities analysts, it is against its policy to disclose any material non-public information or other confidential commercial information. Accordingly, shareholders should not assume that the Company agrees with any statement or report issued by any analyst irrespective of the content of the statement or report. Furthermore, the Company has 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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PART I

Item 1. Business

Overview

Innovative Solutions and Support, Inc. (the Company, or IS&S) was incorporated in Pennsylvania on February 12, 1988. The Company operates in one business segment as a systems integrator that designs, manufactures, sells, and services air data equipment, engine display systems, standby equipment, primary flight guidance and cockpit display systems for retrofit applications and original equipment manufacturers (OEMs). The Company supplies integrated Flight Management Systems (FMS), Flat Panel Display Systems (FPDS), Integrated Standby Units (ISU) and advanced Global Positioning System (GPS) receivers that enable reduced carbon footprint navigation.

The Company has continued to position itself as a system integrator, which capability provides the Company with the potential to generate more substantive orders over a broader product base. The strategy, as both a manufacturer and integrator, is designed to leverage the latest technologies developed for the computer and telecommunications industries into advanced and cost-effective solutions for the general aviation, commercial air transport, United States Department of Defense (DoD)/governmental, and foreign military markets. This approach, combined with the Company s industry experience, is designed to enable IS&S to develop high-quality products and systems, to reduce product time to market, and to achieve cost advantages over products offered by its competitors.

For several years the Company has been working with advances in technology to provide pilots with more information to enhance both the safety and efficiency of flying, and has developed its COCKPIT/IP® Cockpit Information Portal (CIP) product line, that incorporates proprietary technology, low cost, reduced power consumption, decreased weight, and increased functionality. The Company believes the CIP product line is suited to address market demand that will be driven by regulatory mandates, new technologies, and the high cost of maintaining aging/obsolete equipment on airplanes that have been in service for up to fifty years. The Company has incorporated Electronic Flight Bag (EFB) functionality, such as charting and mapping systems, into its FPDS product line.

More recently, the Company has developed an FMS that combines the savings long associated with in flight fuel optimization in enroute flight management combined with the precision of satellite-based navigation required to comply with the regulatory environments of both domestic and international markets. The Company believes that the FMS coupled with its FPDS product line is well suited to address market demand driven by further regulatory mandates, new technologies, and the high cost of maintaining aging and obsolete equipment on aircraft that will be in service for up to fifty years. The shift in the regulatory and technological environment is illustrated by the dramatic increase in the number of Space Based Augmentation System (SBAS) or Wide Area Augmentation System (WAAS) approach qualified airports, particularly as realized through Localizer Performance with Vertical guidance (LPV) navigation procedures. Aircraft equipped with the Company s FMS and FPDS product line (equipped with a SBAS/WAAS/LPV enabled navigator) will be qualified to land at such airports and to comply with upcoming Federal Aviation Administration (FAA) mandates for Required Navigation Performance (RNP), and Automatic Dependent Surveillance-Broadcast (ADS-B) navigation, a fact which IS&S believes will further increase the demand for the Company s products. The Company s FMS/FPDS product line is designed for new production and retrofit applications into general aviation, commercial air transport and military transport aircraft. In addition, the Company offers a state of the art ISU, integrating the full functionality of the primary and navigation displays into a small backup-powered unit. This ISU builds on the Company s legacy air data computer to form a complete next-generation cockpit display and navigation upgrade offering to the commercial and military markets.

IS&S sells to both the OEM and the retrofit markets. Customers include various OEMs, commercial air transport carriers and corporate/general aviation companies, DoD and its commercial contractors, aircraft operators, aircraft modification centers, and foreign militaries. Occasionally, IS&S sells its products directly to DoD; however, the Company sells its products primarily to commercial customers for end use in DoD programs. Sales to defense contractors are generally made on commercial terms, although some of the termination and other provisions of government contracts are applicable to these contracts.

Customers have been and may continue to be affected by the uncertain economic conditions that currently exist both in the United States and abroad. Such conditions may cause customers to curtail or delay their spending on both new and existing aircraft. Factors that can impact general economic conditions and the level of spending by customers include, but are not limited to, general levels of consumer spending, increases in fuel and energy costs, conditions in the real estate and mortgage markets, labor and healthcare costs, access to credit, consumer confidence, and other macroeconomic factors that affect spending behavior. In addition, the Budget Control Act of 2011 (the Budget Act) triggered substantial, automatic reductions in both defense and discretionary spending. The automatic across-the-board sequestration cuts are in addition to reductions already reflected in defense funding over a ten-year period. Furthermore, spending by government agencies may be reduced in the future if tax revenues decline. If customers curtail or delay their spending or are forced to declare bankruptcy or liquidate their operations because of adverse economic conditions, the Company s revenues and results of operations would be affected adversely. However, the Company believes that, in an uncertain economic

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environment, customers that may have otherwise elected to purchase newly manufactured aircraft may be interested instead in retrofitting existing aircraft as a cost-effective alternative, thereby creating market opportunity for IS&S.

In November 2014, the FAA issued its Technical Standard Order authorization (TSO) and Supplemental Type Certificate (STC) to IS&S for use on the B737 Classic aircraft which enabled IS&S to expand its product offering to owners of the B737 in the United States.

In October 2014, Delta Airlines, Inc. (Delta) issued a cancellation notice to the Company purporting to terminate its contract with IS&S. The Company will enter into a contractually mandated non-binding mediation with Delta in accordance with the terms of the contract. (See Item 3. Legal Proceedings).

In February 2014, the FAA issued an STC for the Company s Auto Throttle System and Standby Display Unit (SDU) which has been incorporated into its Integrated Flight Management System (IFMS®). In September 2013, the FAA issued a TSO to IS&S for its SDU, which enabled IS&S to offer the SDU to owners of various aircraft types in the United States, subject to certification of minor technical modifications for use in specific aircraft. This certification led IS&S to develop an ISU, which combines the Company s air data technology with the SDU as a standalone industry product.

In September 2013, the FAA issued a TSO to IS&S for its Digital Air Data Computer (DADC) for the RC-135 aircraft, which enabled IS&S to expand its product offering of the DADC to owners of the RC-135 in the United States.

In May 2013, Pilatus Aircraft Limited (Pilatus) of Switzerland executed an agreement with IS&S to develop and manufacture the Utilities Management System (UMS) for the Pilatus PC-24 aircraft under a multi-year production contract. The UMS integrates multiple aircraft utility functions commonly supported by multiple individual controllers and monitors. The IS&S UMS will provide integrated control of systems from within the avionics suite and automate various tasks to reduce crew workload and improve safety conditions.

In February 2013, Sierra Nevada Corporation awarded IS&S a contract to design, develop, manufacture and supply an upgraded, high definition Integrated Flat Panel Display System for a number of Pilatus PC-12 type aircraft in the United States.

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Industry

A wide range of information is critical for proper and safe operation of aircraft. With advances in technology, new types of information to assist pilots are becoming available for display in cockpits, such as satellite based weather, ground terrain maps, and ADS-B navigation. The Company believes that aircraft cockpits will become more complete information centers, capable of delivering additional information that is either mandated by regulation or demanded by pilots to assist in the safe and efficient operation of aircraft.

The Company classifies flight data into four general types: aircraft heading and altitude information, flight critical aircraft control data, navigation data, and maintenance and aircraft health data. Aircraft heading and altitude information includes aircraft speed, altitude, and rates of ascent and descent. Flight critical aircraft control information includes engine data such as fuel and oil quantity, and other engine measurements. Navigation data includes radio position, flight management, GPS, and alternative source information (i.e. information not originating on the aircraft, including weather depiction maps, GPS navigation, and surface terrain maps). Maintenance and aircraft health data includes on-board sensors and programs to measure parameters related to the health of a system on the aircraft. Air data calculations are based primarily on air pressure measurements derived from sensors on the aircraft. Engine data are determined by measuring various indices such as temperature, volume, revolutions per minute (RPM), and pressure within an aircraft s engines and other mechanical equipment. GPS and alternative source information are derived typically from satellites or equipment located on land and transmitted by satellite or radio signals to the aircraft. Maintenance and aircraft health data measure multiple parameters on various products and interface with various components to manage, measure, and report on the health, reliability and usability of a system. This information is displayed in the cockpit for reference, enhanced position awareness, and reduced support logistics on properly equipped aircraft.

Traditionally, flight data and other cockpit information were displayed on a series of separate analog mechanical instruments. In the early 1980s, Cathode Ray Tubes (CRT) and digital displays using Liquid Crystal Displays (LCD) began to replace some individual analog instruments. Presently, the industry offers high resolution color flat panels using Active Matrix Liquid Crystal Displays (AMLCD) to replace traditional analog instruments, CRT or LCD displays. IS&S expects that the ability to display more information in an efficient space and custom platform will become increasingly important if additional information, such as weather depiction maps, traffic information, surface terrain maps, datalink messaging, and surveillance displays, becomes mandated by regulation or demanded by pilots. Accordingly, the Company believes flat panel displays, which can integrate and display a suite of information, will replace individual instruments CRTs and LCDs on legacy aircraft.

In the past, equipment data, such as engine and fuel related information, were displayed on conventional analog mechanical instruments. Engine and fuel instruments provide information on engine activity, including oil and hydraulic pressures, and temperature. These instruments are clustered throughout an aircraft s cockpit. Engine and fuel instruments tend to be replaced more frequently than other instruments due to obsolescence and normal wear-and-tear. Aircraft operators continue to purchase individual conventional engine and fuel instruments as replacements, because the information that these instruments display is vital for safe and efficient flight. Increasingly, operators are replacing their clusters of analog mechanical instruments with integrated Engine Instrument Display Systems (EIDS) or a FPDS packages.

As the skies and airports become more crowded, the aviation industry and its regulators are concentrating on new technologies, procedures, and regulations that allow more aircraft to operate in the skies and on the ground safely, efficiently, and with less impact on the environment. These new technologies and procedures, such as traffic avoidance, ground awareness, increased precision of navigation and vertical position, runway incursion prevention, and increased digital communication, will require innovation and intuitive methods to display situational awareness information for the pilots. The Company believes that flat panel displays provide the best solution to these requirements.

Strategy

The Company s objective is to become a leading supplier and integrator of cockpit information, and believes that its industry experience and reputation, technology and products, and business strategy provide the basis to achieve this objective. Key elements of the Company s strategy include:

- *Focusing on retrofits.* Cockpit avionics upgrades for existing aircraft is of great interest in the present environment. The retrofit of an aircraft with the COCKPIT/IP® FPDS, FMS, and ISU system components is cost effective compared to the acquisition of a new aircraft and can provide equivalent functionality to that of new aircraft.

- *Establishing leadership in the flat panel display market.* IS&S expects that many aircraft will be retrofitted with flat panel displays over the next several years. Given the versatility, visual appeal, and lower cost of displaying a series of instruments and other flight relevant information on a single flat panel, the Company believes that flat panel displays will increasingly replace individual analog and digital instruments, LCDs and CRTs. The Company believes that the COCKPIT/IP® has significant benefits over competitive flat panel displays, including lower cost, larger size, reduced

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weight, enhanced viewing angles, and a broader array of functions. The Company s patented and proprietary Integrity Checking Processor and Zooming features provide increased situational awareness, reliability, performance, and utility to the owner/operator. Accordingly, the Company believes that these advantages will allow IS&S to generate significant revenues from the COCKPIT/IP® product, and to increase market share. In addition, demand for new aircraft, FAA mandates and obsolescence issues on older aircraft will contribute to this growth.

- *Continuing engineering and product development successes.* IS&S develops innovative products by combining its avionics, engineering, and design expertise with commercially available technologies, components, and products from non-aviation applications, including the personal computer and telecommunications industries. The Company s COCKPIT/IP® system components present examples of its ability to engineer products through the selective application of non-avionic technology. In addition, as permitted by law, IS&S applies for and registers its patents and trademarks for the technology and products it develops in the United States and various countries around the world to protect its intellectual property. Research and development (R&D) expenses were $2.8 million, $2.6 million and $2.7 million for fiscal years ended September 30, 2014, 2013 and 2012, respectively. During fiscal 2014, 2013 and 2012 revenues related to Engineering Development Contracts (EDC) accounted for 32%, 26% and 26%, respectively, of total sales. In support of these EDC programs, the Company charged $15.5 million, $8.3 million, and $4.7 million for fiscal years ended September 30, 2014, 2013 and 2012, respectively to cost of sales.

- *Maintaining leadership in air data markets.* The Company believes that it is one of the largest suppliers of air data products to the U.S. retrofit market. The pressures on DoD procurement budget make the retrofit of aging military aircraft with newer, more advanced, and more supportable air data systems more attractive. In addition, higher performance engines in business aircraft are creating a need for more sophisticated air data products which the Company supplies.

- *Increasing sales to DoD, other government agencies, defense contractors, commercial air transport and corporate/general aviation markets.* IS&S has extended its efforts to diversify sales to include all aviation end user markets, especially legacy military programs and commercial air transport aircraft. In the commercial air transport market, the Company has addressed national carriers, regional carriers, and other fleet operators. The Company has targeted the corporate/general aviation market, both for retrofits and original equipment, and has ongoing retrofit programs and two OEM programs with Eclipse and Pilatus.

- *Expanding international presence.* IS&S plans to increase its international sales by adding sales and marketing personnel. The Company believes that European and other international aircraft operators and aircraft modification centers will retrofit legacy in-service aircraft with large flat panel displays. IS&S obtained approval from the European Aviation Safety Agency (EASA) for installing the FPDS in Europe for the B757/B767 aircraft and expects to obtain EASA approvals for other European aircraft types.

- *Growing through acquisitions or joint ventures.* IS&S may pursue strategic acquisitions or joint ventures as a means to expand the business with enhanced technology, distribution, customer base, or products. The Company may seek to acquire developers or suppliers of complementary products, technology, information, or to acquire suppliers of similar products to increase its product offerings and market share.

Products

Current lines of products include:

Flat Panel Display Systems

Flat panel displays are AMLCD screens that can replicate the display of one or a suite of analog or digital displays on one screen. Flat panel displays can replace existing displays in legacy aircraft. AMLCDs are used also for security monitoring on-board aircraft and as tactical workstations on military aircraft. The flat panel product line offers numerous advantages for presentation of engine performance data. During fiscal years 2014, 2013 and 2012, revenues related to FPDS accounted for 88%, 88% and 87%, respectively, of total sales.

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The Company s FPDS can replace conventional analog and digital displays and can display additional information which is not commonly displayed in the cockpit with conventional analog and digital displays. The COCKPIT/IP® is capable of displaying nearly all types of air data, engine and fuel data, altitude, heading and navigational data, maintenance and aircraft health data, and alternative source information. As technology and information delivery systems develop further, additional information will be displayed in the cockpit, such as surface terrain maps and data link messaging. IS&S designed the COCKPIT/IP® to be capable of displaying information from a variety of sources, including its Reduced Vertical Separation Minimum (RVSM) air data system, engine and fuel instrumentation, and third-party data and information products.

From time to time, customers may order one or more FPDSs customized to their particular requirements. Typically, the Company charges for the added development cost. This revenue is reported as EDC on the consolidated statement of income. Engineering costs incurred in customizing the FPDSs are included in cost of sales.

Flight Management Systems

The IS&S NextGen Flight Management System is an easily installed navigation and performance computer that complements the IS&S Flat Panel Display System upgrade for commercial air transport aircraft. The FMS interfaces with the IS&S SBAS GPS receiver to provide a Global Positioning System (GPS) receiver to provide a GPS based navigation solution. The GPS receiver is located remotely depending on space availability. To minimize use of cockpit space and ease installation efforts, the FMS is housed in an ARINC 739B compliant Multifunction and Control Display Unit (MCDU).

Each FMS/MCDU has an LCD display, keyboard, mode and function keys, line select keys, annunciator lights, and supports ethernet data loading. The flight crew can manually or datalink waypoint flight plans, routes or user-defined waypoints on the IS&S FMS and modify and update these plans via the FMS/MCDU screen. Once the flight plan data is entered, the MCDU computes the most economical flight profiles and provides steering commands for use by the aircraft control system to fly the airplane along the desired route.

The FMS/MCDU package incorporates a robust navigation database capable of storing today s global database with ample growth for the future. Flight crews can utilize the data in the navigation database to create, edit and modify flight plans for display on the FPDS. The navigation data includes airways, jet routes, SIDS, STARS, and company stored routes.

The FMS/MCDU is ARINC 739B compliant, which provides an interface option for other cockpit equipment such as SATCOM, ACARS, CMU, HUD, and a printer. The interface to the IS&S FPDS is provided via Ethernet. The IS&S Electronic Flight Bag (EFB) is integrated with the FMS/MCDU and FPDS where the control selection of the EFB features and applications are handled via the FMS/MCDU. The display is a five inch LCD with VGA resolution. The touchscreen display uses LED backlighting and is sunlight readable.

Integrated Standby Unit

The Company s new Integrated Standby Unit (ISU) incorporates the measurement and display of attitude, altitude, airspeed, and navigation data into a single standby/backup navigation instrument for military, commercial air transport and corporate/general aviation applications. The ISU

has an optional battery module that allows operation of the unit under emergency conditions. The ISU has an integral Inertial Measurement Unit that includes accelerometer, gyro, and magnetometer triads. The unit also includes an integral air data measurement module for measurement of static and total pressure for display of altitude, airspeed, and mach number.

The ISU is a highly reliable and accurate standby navigation system that is based on IS&S s merger of COCKPIT/IP® display technology and RVSM air data products coupled with the latest breakthroughs in MEMS Gyros with exceptional stability. An IS&S proprietary algorithm provides for accurate computation of attitude, heading and air data parameters. The unit includes a triaxial magnetometer that is designed to be tolerant to the local soft iron effects.

The display uses a familiar Primary Flight Display (PFD) format to reduce pilot workload. Logistics and maintenance savings are realized due to increased reliability and a reduction in LRUs. The unit is equipped with built-in test and display of navigational aid and maintenance data.

Air Data Systems and Components

The Company s air data products calculate and display various measures such as aircraft speed, altitude, and rate of ascent and descent. These air data products utilize advanced sensors to gather air pressure data and customized algorithms to interpret data, thus allowing the system to calculate altitude more accurately. During fiscal 2014, 2013, and 2012, sales of air data systems and components accounted for 12%, 12%, and 13%, respectively, of total revenues.

IS&S sells individual components and partial and complete air data systems. The components and systems include:

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- digital air data computers, which calculate various air data parameters such as altitude, airspeed, vertical speed, angle of attack and other information derived from the measure of air pressure;

- integrated air data computers and display units, which calculate and convey air data information;

- altitude displays, which convey aircraft altitude measurements;

- airspeed displays, which convey various airspeed measurements including vertical airspeed and rates of ascent and descent; and

- altitude alerters which allow pilots to select a desired cruising altitude and which provide warnings to pilots when an unacceptable deviation occurs.

Engine and Fuel Displays

IS&S develops, manufactures and markets engine and fuel displays. These solid-state multifunction displays convey information with respect to fuel and oil levels, and engine activity, such as oil and hydraulic pressure and temperature. They include individual and multiple displays installed throughout the cockpit. The displays can be used in conjunction with the Company s engine and fuel data equipment or that of other manufacturers.

Engine and fuel displays are vital to safe flight. In addition, accurate conveyance of engine and fuel information is critical for monitoring engine stress and parts maintenance. Engine and fuel displays tend to be replaced more frequently than other displays, and have been slow to incorporate new technology since their introduction because of their low cost, standard design and universal use.

IS&S believes that its air data engine and fuel displays are extremely reliable, have been designed to be programmable, and are adaptable easily without major modification to most modern aircraft. These products have been installed on B727, B737, C-130H, DC-9, DC-10, P-3, F-16, and A-10 aircraft.

Customers

The Company s customers include the United States government (including DoD, the Department of Interior (DOI) and the Department of Homeland Security (DHS)), American Airlines, Inc. (AAI), Boeing, BAE Systems, Eclipse, FedEx Corporation (FedEx), Icelandair, L-3

Communications, Lockheed Martin Corporation, Pilatus, Sierra Nevada Corporation, and the Department of National Defense (Canada), among others. In fiscal year 2014, the three largest customers, Pilatus, Eclipse and FedEx, accounted for 17%, 14% and 12% of total revenue, respectively. In fiscal 2013, the two largest customers, Eclipse Aerospace and American Airlines, accounted for 24%, and 14% of total revenue, respectively. In fiscal year 2012, the three largest customers, Eclipse, FedEx, and the National Nuclear Security Administration (NNSA), accounted for 20%, 14% and 13% of total revenue, respectively.

Retrofit Market

Historically, a majority of the Company s sales have come from the retrofit market, which IS&S has pursued because of its continued growth in response to the need to support the world s aging fleet of aircraft. The design and airframe structure of many types of older aircraft generally exceeds the technology and technical capabilities of the original cockpit instruments and avionics. The Company has developed products that enable owners and operators to upgrade their aircraft by retrofitting them with IS&S products at a competitive cost and with equipment that provides cockpit displays with capabilities and technology equivalent to new aircraft.

IS&S expects its main customers in the retrofit market will continue to be:

- the DoD and defense contractors,
- aircraft operators, and
- aircraft modification centers.

Department of Defense and Defense Contractors. The Company sells its products directly to the DoD and to domestic and international defense contractors for end use on military aircraft retrofit programs. DoD programs generally take one of two forms: a subcontract with a prime government contractor, such as Boeing, Lockheed Martin, or L-3 Communications, or a direct contract with the appropriate government agency, such as the U.S. Air Force. The government s desire for cost-effective retrofit of its aircraft has led it to purchase commercial off-the-shelf equipment rather than to develop specially designed products, which are usually more costly and take longer to implement. These retrofit contracts tend to be on arms length commercial terms, although some termination and other provisions of government contracts are typically applicable to these contracts, as described under Government Regulation

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below. Each government agency or general contractor retains the right to terminate a contract at any time at its convenience. Upon such alteration or termination, IS&S is entitled typically to be compensated for already delivered items and reimbursement for allowable costs incurred.

Aircraft Operators. The Company sells its products to aircraft operators, including commercial airlines, cargo carriers, and business and general aviation aircraft owners or suppliers, primarily for retrofitting of aircraft owned or operated by these customers. The Company s commercial fleet customers include or have included, among others, AAI, ABX Air, FedEx and Icelandair. IS&S sells these customers a range of products from FPDS to air data systems.

Aircraft Modification Centers. Aircraft modification centers, which repair and retrofit private aircraft, represent the primary retrofit market for private and corporate jets. IS&S has established relationships with a number of aircraft modification centers throughout the United States, which act as distribution outlets for the Company s products.

OEM Market

The Company was selected to provide the cockpit avionics suite for the new Eclipse E550 production aircraft. During the years 2006 through late 2008, the Company provided cockpit displays in support of Eclipse Aviation Inc. s (Aviation) production of approximately 150 aircraft until late 2008 when Aviation filed for bankruptcy. Eclipse purchased the assets of Aviation in 2009. In 2011, Eclipse announced the planned production in 2013 of the E550 aircraft and selected IS&S as the system integrator. During the past five years, IS&S has been providing, through Eclipse, enhanced capability through retrofits to numerous owners of the Aviation produced aircraft.

In May 2013, Pilatus announced that it had selected IS&S to develop and manufacture the Utilities Management System (UMS) for the recently announced Pilatus PC-24 aircraft under a multi-year production contract. The UMS integrates multiple aircraft utility functions commonly supported by multiple individual controllers and monitors. The UMS will provide integrated control of systems from within the avionics suite and automate various normal and emergency tasks to reduce crew workload and improve safety conditions. This open architecture system will allow Pilatus to design and/or refine control and monitoring algorithms internally.

IS&S also markets its products to other original equipment manufacturers including Boeing and Lockheed Martin.

Backlog

	September 30	
	2014	**2013**
	(In Thousands)	
Backlog, beginning of period	$ 91,100	$ 19,712
Plus: bookings during period, net	23,295	102,955
Less: Delta debooking	(61,883)	

Less: revenue recognized during period		(44,095)		(31,567)
Backlog, end of period	$	8,417	$	91,100

Backlog represents the value of contracts and purchase orders, less the revenue recognized to date on those contracts and purchase orders. The year over year decrease of $82.7 million was the result of booking $23.5 million in new business, offset by $62.1 million in debookings of which $61.9 million relates to Delta s purported termination of a contract with IS&S to provide an upgraded cockpit and certain navigation capabilities for its fleet of MD88 and MD90 aircraft, (See Item 3. Legal Proceedings), and $44.1 million of recognized revenue. Air data product backlog as of September 30, 2014 decreased by $3.3 million from September 30, 2013, and FPDS backlog as of September 30, 2014 decreased by $79.4 million from September 30, 2013, reflecting increased FPDS sales during the period and the debooking of Delta . The backlog excludes potential future sole-source production orders from products currently in development under the Company s EDC programs, including the Eclipse E550, the Pilatus PC-24, and the KC-46A, all of which the Company expects to enter into extended production phases upon completion of development. Although the Company believes that the orders included in backlog are firm, most of the backlog involves orders that can be modified or terminated by the customer. As of September 30, 2014, approximately 6% of the Company s backlog was expected to be filled beyond fiscal 2015.

Engineering Development

The Company invests a large percentage of its sales on engineering development, both R&D and EDC. At September 30, 2014, approximately 40% of the Company s employees were engineers engaged in various engineering development projects. Total engineering development expense is comprised of both internally funded R&D and product development and design charges related to specific customer contracts. Engineering development expense consists primarily of payroll-related expenses of employees engaged in EDC projects, engineering related product materials and equipment, and subcontracting costs. R&D charges incurred for product design, product enhancements, and future product development are expensed as incurred. Product development and design charges

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related to specific customer contracts are charged to cost of sales-EDC based on the method of contract accounting (either percentage of completion or completed contract) applicable to such contracts.

Sales and Marketing

IS&S focuses its sales efforts on passenger and cargo carrying aircraft operators, general aviation operators, aircraft modification centers, the DoD, DoD contractors, and OEMs. Periodically, the Company evaluates its sales and marketing efforts with respect to these focus areas and, where appropriate, makes use of third-party sales representatives who receive compensation through commissions based on performance.

The Company s ability to provide prompt and effective repair and upgrade service is critical to its marketing efforts. The Company s customer service program offers a 24-hour customer hotline. The Company services its customers utilizing either field service engineers or its in-house repair and upgrade facility. The Company may lend spare units to customers when it is repairing or overhauling their equipment. The Company s in-house turnaround times for both repairs and upgrades average less than 30 days. IS&S provides customers with a standard two-year warranty on new products. The Company offers customers extended warranties of varying lengths beyond the two years for additional fees.

The majority of the Company s sales, personnel and assets are within the United States. In fiscal year 2014, 2013 and 2012 net sales outside the United States amounted to $12.0 million, $4.8 million and $4.4 million, respectively.

Government Regulation

FAA regulations govern the manufacture and installation of the Company s products in aircraft owned and operated in the United States, and the IS&S facility is FAA certified. The most significant product and installation regulations are TSO and STC, which establish the minimum product performance standards.

Generally, sales of IS&S products to European or other non-U.S. owners of aircraft require approval of EASA, or other relevant governmental agencies. EASA certification requirements for the manufacture and installation of the Company s products in European owned aircraft mirror FAA regulations, and its process for European certification is similar to that of the FAA.

In addition to product related regulations, IS&S is subject to U.S. Government procurement regulations with respect to the sale of the Company s products to government entities or government contractors. The government agency or general contractor retains the right to terminate a contract at any time at its convenience. Upon such alteration or termination, IS&S is generally entitled to an equitable adjustment to the contract price so that the Company receives the purchase price for products or services already delivered and reimbursement for allowable costs incurred and for termination related costs.

Manufacturing, Assembly and Materials Acquisition

The Company s manufacturing activities consist primarily of assembling and testing components and subassemblies, and integrating them into finished systems. Typically, the Company purchases components for products from third-party suppliers and assembles them in a clean room environment. Many of the components purchased are standard products, although certain parts are made to the Company s specifications.

When appropriate, IS&S enters into long-term supply agreements and uses its relationships with long-term suppliers to improve product quality and availability, and to reduce delivery times and product costs. In addition, the Company identifies alternative suppliers for important component parts. Generally, the introduction of component parts from new suppliers into existing products requires FAA certification of the entire finished product if the newly sourced component varies significantly from the original drawings and specifications. IS&S has not experienced significant delays in delivery of products caused by the inability to obtain either component parts or FAA approval of products incorporating new component parts.

Quality Assurance

Product quality is of vital importance. The Company is ISO 9001 and AS9100C certified. These standards represent an international consensus on effective management practices with the goal of ensuring that a company can deliver its products and related services consistently in a manner that meets or exceeds customer quality requirements. IS&S s certification to these standards allows the Company to represent to customers that it maintains high quality industry standards in the education of its employees, and in the design and manufacture of its products. In addition, the Company s products undergo extensive and documented quality control testing prior to being delivered to customers.

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Competition

The market for the Company s products is highly competitive. Competitors vary in size and resources, and substantially all of the Company s competitors are much larger than IS&S and have substantially greater resources. With respect to air data systems and related products, the Company s principal competitors include Honeywell International Inc. (Honeywell), Rockwell Collins, Inc., Thales Communications, Inc. (Thales), and Garmin Ltd. (Garmin). With respect to flat panel displays, principal competitors currently include Honeywell, Rockwell Collins, Inc., L-3 Communications, Garmin and GE Aviation Systems (GEAS). However, as the flat panel display industry evolves and the demand for flat panel displays increases, IS&S may face future competition in this area from other suppliers.

The Company believes that the principal competitive factors in its markets are cost, development cycle time, responsiveness to customer preferences, product quality, technology, and reliability. IS&S believes that its significant and long-standing customer relationships reflect the Company s ability to compete favorably with respect to these factors.

Intellectual Property and Proprietary Rights

IS&S relies on patents to protect its proprietary technology. As of September 30, 2014, the Company holds 29 U.S. patents and has 6 U.S. patent applications pending relating to its technology. In addition, IS&S holds 59 international patents and has 26 international patent applications pending. Certain of these patents and patent applications cover technology relating to air data measurement systems and others cover technology relating to flat panel display systems and other aspects of the COCKPIT/IP® solution. While IS&S believes these patents have significant value in protecting its technology, it believes that the innovative skill, technical expertise, and know-how of the Company s personnel in applying the technology reflected in its patents would be difficult, costly, and time consuming to reproduce.

While IS&S is not aware of any pending lawsuits against the Company alleging patent infringement or the violation of other intellectual property rights, it cannot be certain such infringement claims will not be asserted against the Company in the future.

Employees

As of September 30, 2014, IS&S had 146 employees. The Company s future success depends on its ability to attract, train and retain highly qualified personnel. Competition for such qualified personnel is intense, and the Company may not be able to attract, train, and retain highly qualified personnel in the future. The Company is not unionized.

Executive Officers of the Registrant

The following is a list of the Company s executive officers, their ages and their positions in each case. Effective December 15, 2014, Ronald C. Albrecht, the Company chief financial officer during fiscal 2014, will retire as the Company s chief financial officer and be succeeded by Relland M. Winand:

Name	Age	Position
Geoffrey S. M. Hedrick	72	Chairman of the Board and Chief Executive Officer
Shahram Askarpour	57	President
Ronald C. Albrecht	69	Chief Financial Officer - Will retire effective December 15
Relland M. Winand	60	Chief Financial Officer

Geoffrey S. M. Hedrick was the Chief Executive Officer from the time he founded the Company in February 1988 through June 4, 2007, and was reappointed as Chief Executive Officer on September 8, 2008. He has been Chairman of the Board since 1997. Prior to founding IS&S, Mr. Hedrick served as President and Chief Executive Officer of Smiths Industries North American Aerospace Companies. He founded Harowe Systems, Inc. in 1971, which was subsequently acquired by Smiths Industries. Mr. Hedrick has over 40 years of experience in the avionics industry, and he holds a number of patents in the electronics, optoelectric, electromagnetic, aerospace, and contamination control fields.

Shahram Askarpour has been President since April 2012. Dr. Askarpour joined the Company as a Director of Engineering in 2003, was promoted to Vice President of Engineering in 2005, and was promoted to President on April 2, 2012. Dr. Askarpour has more than 30 years of aerospace industry experience in managerial and technical positions. Prior to joining IS&S, he was employed by Smiths Aerospace (a division of Smiths Group PLC), Instrumentation Technology and Marconi Avionics. He holds a number of key patents in the aviation field. Dr. Askarpour received his engineering education in the United Kingdom, and received an undergraduate degree in Electrical Engineering from Middlesex University, a post graduate Certificate of Advanced Study in Systems Engineering, and a PhD in Automatic Control from Brunel University. He was awarded the title of Associate Research Fellow for three consecutive years by Brunel University, and has published numerous papers in leading international, peer reviewed journals. In addition, he has completed management courses at Carnegie Mellon University and finance courses at the Wharton Business School.

Ronald C. Albrecht has been Chief Financial Officer since August 2010. Prior to joining the Company, Mr. Albrecht served in a number of executive positions, both operational and financial, with Smiths Aerospace (UK). Smiths Aerospace was acquired by General Electric Aviation Systems (GEAS) in 2007. Most recently, Mr. Albrecht served as Vice President and General Manager of Smiths Aerospace Electro Mechanical Business from 2003 to 2007 and, subsequently, of GEAS Electro Mechanical Business from 2007 to 2010. Prior to his operational roles, he served as Chief Financial Officer of Smiths Aerospace, based in London, and has substantial mergers & acquisition and strategic planning experience. Mr. Albrecht received a B.A. in Government and Economics from Dartmouth College and a M.B.A. in Finance from Stanford University. He is a Certified Public Accountant (California/Inactive). Mr. Albrecht will retire as the Company s chief financial officer effective December 15, 2014.

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Relland M. Winand has been appointed to succeed Mr. Albrecht as the Company s chief financial officer effective December 15, 2014. Mr. Winand has served in a number of executive financial capacities with public companies including Chief Financial Officer of ECC International, Corp, a manufacturer of computer controlled maintenance simulators primarily for the Department of Defense, and Vice President Finance and Administration of Traffic.com, Inc. a leading provider of accurate, real-time traffic information in the United States. Prior to joining Innovative Solutions and Support, Inc., from 2008 to 2013, Mr. Winand was Chief Financial Officer of Orbit/FR, Inc., an international developer and manufacturer of sophisticated microwave test and measurement systems for aerospace/defense, wireless, satellite and automotive industries. From January 2014 until August 2014, Mr. Winand served as a consultant for Solomon Edwards Group LLC. He has over 30 years experience in financial management and reporting for both public domestic and international manufacturing companies. Mr. Winand received a B.S. in Accounting from Drexel University and an M.B.A. in Finance from Widener University.

Other

The public may read and copy any materials filed by IS&S with the SEC at the SEC s public reference room located at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information about the operation of the SEC s public reference rooms by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at http://www.sec.gov that contains reports, proxy and information statements, and other information about issuers that file electronically with the SEC.

IS&S maintains its corporate website at http://www.innovative-ss.com and makes available, free of charge, on that website (under the Investor Relations tab) the Company s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those as reasonably practicable after it electronically files such material with, or furnishes it to, the SEC. The information on the Company s web site is not incorporated as part of this Annual Report on Form 10-K.

Item 1A. Risk Factors

Each reader should carefully consider the risks, uncertainties and other factors described below, in addition to the other information set forth in this report, because they could materially and adversely affect the Company s business, operating results, financial condition, cash flows, prospects, and the value of an investment in IS&S common stock.

Risks Related to IS&S Business

Reductions in government expenditures could adversely affect IS&S business.

The Budget Act of 2011 triggered substantial, automatic reductions in both defense and discretionary spending. The automatic across-the-board sequestration cuts are in addition to reductions already reflected in the defense funding over a ten-year period and could have significant consequences to the Company s business and industry. While the full impact of sequestration is undetermined, the impact of any resulting reductions in defense appropriations, and/or reductions in U.S. defense spending could result in delays in procurement of products and services due to lack of funding, and negatively affect the IS&S s revenues, financial condition and results of operations.

The ongoing global uncertainty and concern regarding credit availability could adversely affect IS&S.

The global uncertainty and continued concern regarding credit availability, including failures of financial institutions, has produced unprecedented government intervention in the U.S., Europe and other regions of the world. If these concerns continue or worsen, risks to IS&S include:

- declines in revenues and profitability from reduced orders, payment delays or other factors caused by the economic problems of customers;

- reprioritization of government spending away from defense programs in which IS&S participates;

- reduced access to credit sources; and

- disruptions in supplies associated with any financial constraints faced by vendors.

A portion of IS&S sales has been, and is expected to continue to be, from defense contractors or government agencies in connection with government aircraft retrofit or original equipment manufacturing contracts. Sales to government contractors and government agencies could decline as a result of DoD spending cuts and general budgetary constraints which may become more severe as the federal budget deficit remains high.

The loss of a key customer or a significant deterioration in the financial condition of a key customer could have a material adverse effect on the Company s results of operations.

The Company s revenue is concentrated with a limited number of customers. During fiscal year 2014 IS&S derived 59% of revenue from the top five customers. IS&S expects a relatively small number of customers to account for a majority of its revenues for the

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foreseeable future. As a result of the concentrated customer base, a loss of one or more of these customers or a dispute or litigation with one of these key customers could affect adversely its revenue and results of operations. For example, in October 2014, Delta issued a cancellation notice to the Company purporting to terminate its contract with IS&S. The Company will enter into a contractually mandated non-binding mediation with Delta in accordance with the terms of the contract. (See Item 3. Legal Proceedings).

In addition, the Company monitors and evaluates the credit status of its customers and attempts to adjust sales terms as appropriate. Despite these efforts, a significant deterioration in the financial condition or bankruptcy filing of a key customer could affect adversely the Company s business, results of operations, and financial condition.

Growth of the Company s customer base could be limited by delays or difficulties in completing development and introduction of planned products or product enhancements. If IS&S fails to enhance existing products, or to develop and achieve market acceptance for flat panel displays, flight management systems and other new products that meet customer requirements, its business, reputation and statements of income may be affected adversely.

Currently, IS&S spends a large portion of its R&D efforts in developing and marketing the FPDS, FMS, and complementary products. The Company s ability to grow and diversify its operations through introduction and sale of new products is dependent upon the continued success in product development and engineering activities, its sales and marketing efforts, and regulatory approvals to sell such products. Sales growth will depend in part on market acceptance of and demand for the FPDS, FMS, and future products. IS&S cannot be certain that it will be able to develop, introduce or market its FPDS, FMS, or other new products or product enhancements in a timely or cost-effective manner, or that any new products will receive market acceptance or necessary regulatory approval. In addition, the Company s business is dependent upon maintaining its reputation and relationships with existing customers. If the Company s performance does not meet its customers expectations, the Company s reputation and its relationships could be damaged, which may have a material adverse impact on the Company s business and statements of income.

In seeking new customers, the Company may have difficulty in displacing the products of incumbent competitors. IS&S cannot be assured that potential customers will accept its products or that existing customers will not abandon them.

The Company s revenue and operating results may vary significantly from quarter to quarter, which may cause its stock price to decline.

The Company s revenue and operating results may vary significantly from quarter to quarter because of a number of factors, including:

- demand for products and/or delivery schedule changes by its customers;

- capital expenditure budgets of aircraft owners and operators, and appropriation cycles of the U.S. government;

- changes in the use of the Company s products, including air data systems, flat panel displays, and flight management systems;
- delays in introducing or obtaining government approval for new products;
- new product introductions by competitors;
- changes in IS&S pricing policies or pricing policies of competitors; and
- costs related to possible acquisition of technologies or businesses.

Contracts can be terminated by customers at any time and, therefore, may not result in sales.

The Company s retrofit projects are generally pursuant to either a direct contract with a customer or a subcontract with a general contractor to a customer (including government agencies). Each contract, including contracts with government agencies, includes various terms and conditions that impose certain requirements on IS&S, including the ability of the government agency or general contractor to alter the price, quantity or delivery schedule of the products. Additionally, each government agency or general contractor retains the right to terminate the contract at any time at its convenience. Upon alteration or termination of these contracts, IS&S is entitled typically to an equitable adjustment to the contract price so that it would be compensated for delivered items and allowable costs incurred. Accordingly, because these contracts can be terminated, the Company cannot be assured that its backlog will result in sales. For example, in October 2014, Delta issued a cancellation notice to the Company purporting to terminate its contract with IS&S resulting in $61.9 million of debookings with respect thereto.

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The Company enters into fixed-price contracts or service arrangements to perform specified design and EDC services related to its products that could subject IS&S to losses in the event the Company incurs cost overruns on its projects.

During fiscal 2014, approximately 32% percent of the Company s total sales were from fixed-price EDC arrangements with customers to perform specified design and EDC services related to its products. These arrangements allow IS&S to benefit by recovering some of its product development costs, but it carries the risk of potential cost overruns. If the Company s initial cost estimates are incorrect, it can incur potentially large one time charges and losses on these contracts. These EDC arrangements can expose the Company to potential losses because the customer may compel IS&S to complete a project or, in the event of a termination for default, pay the incremental cost of its replacement by another provider. Because some of these projects involve new technologies and applications, and can last for more than a year, unforeseen events such as technological difficulties, fluctuations in the price of raw materials, problems with subcontractors, and cost overruns can result in the contractual price becoming less favorable or even unprofitable to IS&S over time. Furthermore, if the Company does not meet project deadlines or if its products do not meet customer specifications, it may need to renegotiate contracts on less favorable terms, be forced to pay penalties or liquidated damages, or suffer losses if the customer exercises its right to terminate. The Company s results of operations are dependent on its ability to maximize earnings from the EDC service arrangements. Lower earnings caused by cost overruns could have a negative impact on the Company s financial condition, operating results, and cash flows.

IS&S depends on key personnel to manage its business effectively, and an inability to retain its key employees could adversely impact the Company s ability to compete.

The Company s success depends on the efforts, abilities, and expertise of its senior management and other key personnel. There can be no assurance IS&S will be able to retain such employees, and the loss of some could damage its ability to execute its business strategy. The Company intends to continue hiring key management, engineering, and sales and marketing personnel. Competition for skilled personnel is intense, and IS&S may not be able to attract or retain additional qualified personnel.

The Company s future success will depend in part on its ability to implement and improve its operational, administrative and financial systems and controls and to manage, train and expand its employee base. IS&S cannot provide assurance that, after giving effect to its cost containment initiatives, that current and planned personnel levels, systems, procedures, and controls will be adequate to support the current and future customer base. In such a circumstance, the Company may not be able to exploit existing and potential market opportunities. Any delays or difficulties encountered could impair the Company s ability to attract new customers or maintain its relationships with existing customers.

IS&S relies on third party suppliers for components of its products, and any interruption in the supply of these components could hinder its ability to deliver products on a timely basis.

The Company s manufacturing process consists primarily of assembling components purchased from its supply chain. The suppliers may not continue to be available to IS&S. If the Company is unable to maintain relationships with key third party suppliers, the development and distribution of its products could be delayed until equivalent components can be obtained and integrated into the products. In addition, substitution of certain components from other manufacturers may require product redesign, FAA or other approval, which could delay the Company s ability to ship products.

The Company s competition includes other manufacturers of air data systems and flight information displays against whom it may not be able to compete successfully.

The markets for the Company s products are intensely competitive and subject to rapid technological change. Competitors include Honeywell, Rockwell Collins, Inc., Thales, GEAS, and L-3 Communications. All these competitors have substantially greater financial, technical, and human resources than does IS&S. In addition, these competitors have much greater experience in and resources for marketing their products. As a result, these competitors may be able to respond more quickly to new or emerging technologies and customer preferences, or to devote greater resources to development, promotion and sale of their products than IS&S can. The Company s competitors may have greater name recognition and more extensive customer bases. Such competition could result in price reductions, fewer customer orders, reduced gross margins, and loss of market share.

The Company s success depends on its ability to protect its proprietary rights against potential risk of infringement. If IS&S is unable to protect and enforce its intellectual property rights, it may be unable to compete effectively.

The Company s success and ability to compete will depend in part on its ability to obtain and maintain patent or other protection for its technology and products, both in the United States and internationally. In addition, IS&S must operate without infringing the proprietary rights of others.

IS&S currently holds 29 U.S. patents and has 6 U.S. patent applications pending. In addition, the Company holds 59 international patents and has 26 international patent applications pending. IS&S cannot be certain that patents will be issued on any of its present or future applications. In addition, existing patents or future patents may not adequately protect the Company s technology if they are not

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broad enough and are successfully challenged, or if other entities are able to develop competing methods without violating its patents. If IS&S is not successful in protecting its intellectual property, competitors could begin to offer products that incorporate the Company s technology. Patent protection involves complex legal and factual questions, and, therefore, is highly uncertain. Litigation relating to intellectual property is often very time consuming and expensive. If a successful claim of patent infringement were made against IS&S, and if the Company were unable to develop non-infringing technology, or to license the infringed or similar technology on a timely and cost-effective basis, the Company might not be able to produce and sell some of its products. Further, IS&S has incurred, and may continue to incur, significant legal and other costs in defense of its intellectual property.

A cyber security incident could have a negative impact.

A cyber-attack that bypasses the Company s information technology (IT) security systems causing an IT security breach, may lead to a material disruption of its IT business systems and/or the loss of business information resulting in an adverse business impact. Risks may include:

- negative impact on future results due to the theft, destruction, loss, misappropriation, or release of confidential data or intellectual property;

- operational or business delays resulting from the disruption of IT systems and subsequent clean-up and mitigation activities; and

- negative publicity resulting in reputation or brand damage with customers, partners or industry peers.

Tax changes could affect the Company s effective tax rate and future profitability.

The Company s future results could be affected negatively by changes in the effective tax rate as a result of changes in the overall profitability and changes to statutory tax rates in the United States, changes in tax legislation, and the results of audits and examinations of previously filed tax returns.

IS&S may not be able to identify or complete acquisitions, or it may consummate an acquisition that adversely affects the Company s operating results.

One of the Company s strategies may be to acquire businesses or technologies that complement its existing operations. IS&S has limited experience in acquiring businesses or technologies. There can be no assurance IS&S will be able to acquire or profitably manage acquisitions or successfully integrate them into its operations. Furthermore, certain risks are inherent in pursuing acquisitions, such as the demands of management s time and attention and integrating disparate company cultures and facilities. Acquisitions may have an adverse effect on the Company s operating results, particularly in quarters immediately following the consummation of such transactions, as the Company integrates

operations of acquired businesses into its operations. Once integrated, acquisitions may not perform as expected or be accretive to the Company s results of operations.

Risks Related to the Company s Industry

If IS&S is unable to respond to rapid technological change, its products could become obsolete and its reputation could suffer.

Future generations of flat panel displays, air data systems, engine and fuel displays, and flight management systems which embody new technologies or new industry standards could render the Company s products obsolete. The market for aviation products is subject to rapid technological change, new product introductions, changes in customer preferences, and evolving industry standards and government regulations. The Company s future success will depend on its ability to:

- embrace rapidly changing technologies;

- adapt the Company s products to evolving industry standards and government regulations; and

- develop and introduce timely, high quality, cost effective new products, and product enhancements to address the increasingly sophisticated needs of its customers.

If IS&S fails to modify or improve its products in response to evolving industry standards and government regulations, its products could rapidly become obsolete.

The Company s products are currently subject to direct regulation by the FAA and other equivalent organizations. The Company s products, as they relate to aircraft applications, must be approved by the FAA, EASA, or other equivalent organizations before they can be installed in an aircraft. To be certified, IS&S must demonstrate that its products are accurate and able to maintain certain levels

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of repeatability over time. Although certification requirements of the FAA and EASA are substantially similar, no formal reciprocity exists between the two regulators. Accordingly, even though the Company s products are FAA approved, it may need to obtain approval from EASA or other appropriate organizations to have them certified for installation outside the United States.

Significant delay in receiving certification for newly developed products or enhancements to the Company s products, or the loss of certification for its existing products, could result in lost sales or delays in sales. Furthermore, new regulations or product standards, and changes to existing product standards could require IS&S to change its products and underlying technology. IS&S cannot ensure that it will receive regulatory approval on a timely basis or at all.

Inasmuch as the Company s products utilize sophisticated technology and are deployed in complex aircraft cockpit environments, problems with these products may arise that could harm the Company s reputation for quality assurance and, consequently, its business prospects.

The Company s products use complex system designs and components that may contain errors, omissions, or defects, particularly when the Company incorporates new technologies into its products or when it releases new versions or enhancements of its existing products. Despite the Company s quality assurance process, errors, omissions or defects could occur in its current products, in new products, or in new versions or enhancements of existing products. IS&S may be required to redesign or recall those products or pay damages. Such an event could result in the following:

- delay or loss of revenues;
- cancellation of customer contracts;
- diversion of development resources;
- damage to the Company s reputation;
- increased service and warranty costs; or
- litigation costs.

Although IS&S carries product liability insurance, this insurance may not be adequate to cover its losses in the event of a large product liability claim. In addition, IS&S may not be able to maintain such insurance in the future.

The Company has limited experience in marketing and distributing its products internationally.

IS&S plans to derive increasing revenues from sales outside the United States, particularly in Europe. Risks inherent in doing business internationally include:

- differing regulatory requirements;
- legal uncertainty regarding liability;
- tariffs, trade barriers, and other regulatory barriers;
- political and economic instability;
- changes in diplomatic and trade relationships;
- potentially adverse tax consequences;
- the impact of recessions in economies outside the United States; and
- variances and unexpected changes in local laws and regulations.

Currently, all of the Company s international sales are denominated in U.S. dollars. An increase in the dollar s value compared to other currencies could render its products less competitive in the international markets. In the future, IS&S may be required to conduct sales in the foreign country s local currency, thus exposing the Company to fluctuations and volatility in exchange rates that could adversely affect its operating results.

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Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

In fiscal 2001, IS&S purchased 7.5 acres of land in the Eagleview Corporate Park in Exton, Pennsylvania. Shortly thereafter, the Company constructed a 45,000 square foot design, manufacturing and office facility on this site. Land development approval allows for expansion of up to 20,400 square feet. Such expansion would provide for a 65,400 square foot facility which the Company believes is adequate to meet the needs of the Company for the foreseeable future.

The Company also occupies approximately 8,358 square feet of office and warehouse space in Exton, Pennsylvania under a lease expiring March, 2018. The lease contains two options to extend the lease for a total of six additional years. The Company s current annual lease expense for this property is approximately $52,000.

Item 3. Legal Proceedings.

In the ordinary course of business, the Company is subject to various legal proceedings and claims. IS&S does not believe any such matters that are currently pending will have a material effect on the Company s results of operations or financial position, except as described below with respect to the Delta matter.

In October 2014 the Company announced that Delta had issued a cancellation notice to the Company purporting to terminate its contract with IS&S to develop, manufacture and install new cockpit displays and certain navigation capabilities on Delta s fleet of approximately 182 MD88 and MD90 aircraft. On October 6, 2014 Delta sent the Company a cancellation notice citing alleged schedule delays and technical infeasibility. The Company believes that Delta s purported termination of the contract was wrongful and in breach of the terms of the contract. The contract provides for non-binding mediation in the event of such a dispute, and the Company has initiated the mediation process. The Company had $3.7 million of unbilled receivables and $0.2 million of inventory on its balance sheet relating to the Delta program at September 30, 2014 both of which are fully reserved. At this time, the outcome of the mediation and any potential subsequent negotiation with or litigation against Delta is not determinable.

On January 17, 2007 the Company filed suit in the Court of Common Pleas for Delaware County, Pennsylvania against Strathman Associates, a former software consultant for IS&S, alleging that Strathman had improperly used IS&S trade secret and proprietary information in assisting J2 and Kollsman in developing the J2/Kollsman Air Data Computer. The case has not been resolved as of the date hereof.

Item 4. Mine Safety Disclosures.

Not applicable.

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Part II

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

The Company s common stock has been traded on the NASDAQ Stock Market, LLC under the symbol ISSC since its initial public offering on August 4, 2000. The following table lists the high and low per share sale prices for the common stock for the periods indicated:

	Fiscal Year 2014		Fiscal Year 2013	
Period	**High**	**Low**	**High**	**Low**
First Quarter	$ 8.07	$ 6.57	$ 5.41	$ 3.20
Second Quarter	8.82	6.27	4.93	3.36
Third Quarter	7.89	6.13	9.25	4.56
Fourth Quarter	7.91	5.12	8.41	6.38

On November 28, 2014, there were 16 holders of record of the shares of outstanding common stock. This total does not reflect beneficial shareholders who hold their stock in nominee or street name through brokerage firms.

On April 17, 2014 the Company s Board of Directors approved the extension of the current share repurchase program (originally approved on April 29, 2013) which allows the Company to acquire up to 250,000 shares of its outstanding common stock until May 1, 2015. Under the share repurchase program, the Company may purchase shares of its common stock through open market transactions, in privately negotiated block purchases, or in other private transactions (either solicited or unsolicited). The timing and amount of repurchase transactions under this program will depend on market conditions, and subject to corporate and regulatory considerations. The program may be discontinued or suspended at any time. During the years ended September 30, 2014 and 2013, the Company did not make any purchases of shares of the Company s common stock under the share repurchase plan. As at September 30, 2014, the number of shares that may be yet purchased under the new share repurchase program was 250,000 shares.

On December 7, 2012 the Company s Board of Directors declared a special cash dividend in the amount of $1.50 per share, payable on or about December 27, 2012 to shareholders of record as of the close of business on December 17, 2012. The total dividend payment was approximately $25 million. The Company did not pay dividends in fiscal 2014 or fiscal 2012. The declaration and payment of any dividend in the future will be at the discretion of the Company s Board of Directors.

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The graph below shows the cumulative shareholder return on $100 invested at the market close on September 30, 2009 through and including September 30, 2014, the last trading day before the end of the Company s most recently completed fiscal year, with the cumulative total return over the same time period of the same amount invested in the NASDAQ Composite Index, the Russell 2000 Index, and the Dow Jones US Aerospace & Defense Index.

	9/09	9/10	9/11	9/12	9/13	9/14
Innovative Solutions and Support, Inc.	**100.00**	**97.60**	**96.41**	**79.44**	**228.57**	**149.75**
NASDAQ Composite	**100.00**	**112.55**	**116.28**	**153.12**	**189.49**	**227.09**
Russell 2000	**100.00**					