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SPACEDEV INC
Form 10QSB
May 11, 2004

FORM 10-QSB

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20429

(Mark One)

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

For the quarterly period ended March 31, 2004

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 000-28947.

SPACEDEV, INC.

(Exact name of registrant as specified in its charter)

Colorado 84-1374613

(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)

13855 Stowe Drive, Poway, California 92064

(Address of principal executive offices)

(Issuer's telephone number) (858) 375-2030.

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

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

State the number of shares outstanding of each of the issuer's classes of common
equity, as of the latest practicable date: 17,813,704 shares of Issuer's voting
common stock were outstanding on April 26, 2004.

SPACEDEV, INC.

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FORM 10-QSB
FOR THE QUARTER ENDED MARCH 31, 2004

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PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SPACEDEV, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

At March 31, 2004 2003

ASSETS

CURRENT ASSETS

| | | |
|------------------------------|------------|-----------|
| Cash | \$ 981,898 | \$210,856 |
| Accounts receivable. | 296,980 | 220,841 |

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| | | |
|--|-------------|-----------|
| Work in Progress | 135,988 | - |
| Costs in excess of billings and estimated earnings | - | 253,819 |
| Inventory. | 8,142 | - |
| ----- | | |
| Total current assets. | 1,423,008 | 685,516 |
| | | |
| FIXED ASSETS - NET. | 129,598 | 131,475 |
| | | |
| CAPITALIZED SOFTWARE COSTS | - | 69,005 |
| | | |
| OTHER ASSETS. | 43,223 | 31,536 |
| ----- | | |
| | \$1,595,829 | \$917,532 |
| ----- | | |

The accompanying notes are an integral part of these consolidated financial statements.

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SPACEDEV, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| | | |
|---|-----------|--------|
| At March 31, | 2004 | 2003 |
| ----- | | |
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| CURRENT LIABILITIES | | |
| Current portion of notes payable | 37,961 | \$ 55, |
| Current portion of capitalized lease obligations | 7,012 | 28, |
| Note payable - related party (Note 3(b)) | 80,000 | 80, |
| Convertible debt notes payable (Note 4). | - | 229, |
| Accounts payable and accrued expenses. | 254,352 | 321, |
| Accrued payroll, vacation and related taxes. | 153,913 | 111, |
| Customer deposits and deferred revenue | - | 124, |
| Provision for anticipated loss (Note 2). | - | 5, |
| Income taxes payable | - | 40, |
| Revolving credit facility (Note 3(c)). | 1,001,043 | |
| Other accrued liabilities. | 183,071 | |
| ----- | | |
| TOTAL CURRENT LIABILITIES | 1,717,352 | 997, |
| | | |
| NOTES PAYABLE, LESS CURRENT MATURITIES (NOTE 3(A)). | 37,130 | 76, |
| | | |
| CAPITALIZED LEASE OBLIGATIONS, LESS CURRENT MATURITIES. | 4,369 | 3, |
| | | |
| NOTE PAYABLE - RELATED PARTY, LESS CURRENT MATURITIES | 500,113 | 528, |
| | | |
| DEFERRED GAIN - ON BUILDING SALE (NOTE 3(A)). | 1,035,903 | 1,153, |
| | | |
| DEFERRED REVENUE. | 5,000 | 5, |
| ----- | | |

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| | | |
|---|--------------|----------|
| TOTAL LIABILITIES | 3,299,867 | 2,764, |
| ----- | | |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERSDEFICIT | | |
| Convertible preferred stock, \$.0001 par value, 10,000,000 shares authorized no shares issued or outstanding. | - | |
| Common stock, \$.0001 par value; 50,000,000 shares authorized, and 17,023,704 and 15,338,907 shares issued and outstanding, respectively. | 1,702 | 1, |
| Additional paid-in capital (Note 5). | 10,054,585 | 8,728, |
| Additional paid-in capital - stock options | 750,000 | 750, |
| Deferred compensation. | (250,000) | (250, |
| Accumulated deficit. | (12,260,325) | (11,076, |
| ----- | | |
| TOTAL STOCKHOLDERSDEFICIT | (1,704,038) | (1,846, |
| ----- | | |
| | 1,595,829 | 917, |
| ----- | | |
| | | |

The accompanying notes are an integral part of these consolidated financial statements.

SPACEDEV, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | | |
|---|-----------|--------|
| At March 31, | 2004 | 2003 |
| ----- | | |
| LIABILITIES AND STOCKHOLDERSDEFICIT | | |
| CURRENT LIABILITIES | | |
| Current portion of notes payable | 37,961 | \$ 55, |
| Current portion of capitalized lease obligations | 7,012 | 28, |
| Note payable - related party (Note 3(b)) | 80,000 | 80, |
| Convertible debt notes payable (Note 4). | - | 229, |
| Accounts payable and accrued expenses. | 254,352 | 321, |
| Accrued payroll, vacation and related taxes. | 153,913 | 111, |
| Customer deposits and deferred revenue | - | 124, |
| Provision for anticipated loss (Note 2). | - | 5, |
| Income taxes payable | - | 40, |
| Revolving credit facility (Note 3(c)). | 1,001,043 | |
| Other accrued liabilities. | 183,071 | |
| ----- | | |
| TOTAL CURRENT LIABILITIES | 1,717,352 | 997, |
| NOTES PAYABLE, LESS CURRENT MATURITIES (NOTE 3(A)). | 37,130 | 76, |
| CAPITALIZED LEASE OBLIGATIONS, LESS CURRENT MATURITIES. | 4,369 | 3, |
| NOTE PAYABLE - RELATED PARTY, LESS CURRENT MATURITIES | 500,113 | 528, |

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| | | |
|---|--------------|----------|
| DEFERRED GAIN - ON BUILDING SALE (NOTE 3(A)) | 1,035,903 | 1,153, |
| DEFERRED REVENUE | 5,000 | 5, |
| TOTAL LIABILITIES | 3,299,867 | 2,764, |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERSDEFICIT | | |
| Convertible preferred stock, \$.0001 par value, 10,000,000 shares authorized no shares issued or outstanding. | - | |
| Common stock, \$.0001 par value; 50,000,000 shares authorized, and 17,023,704 and 15,338,907 shares issued and outstanding, respectively. | 1,702 | 1, |
| Additional paid-in capital (Note 5). | 10,054,585 | 8,728, |
| Additional paid-in capital - stock options | 750,000 | 750, |
| Deferred compensation. | (250,000) | (250, |
| Accumulated deficit. | (12,260,325) | (11,076, |
| TOTAL STOCKHOLDERSDEFICIT | (1,704,038) | (1,846, |
| | 1,595,829 | 917, |

The accompanying notes are an integral part of these consolidated financial statements.

SPACEDEV, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| Three-Months Ending March 31, | 2004 | 2003 |
|---|-------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss. | \$(442,549) | \$ (505,087) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization. | 15,954 | 57,696 |
| Gain on on building sale | (29,318) | (19,545) |
| Non-cash interest expense - convertible debt program | - | 100,455 |
| Non-cash loan fees | 464,000 | - |
| Change in operating assets and liabilities:. | (168,910) | (364,573) |
| NET CASH USED IN OPERATING ACTIVITIES. | (160,823) | (731,054) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from the sale of building. | - | 3,150,124 |
| Purchases of fixed assets | (8,020) | (3,100) |
| NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES | (8,020) | 3,147,024 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Principle payments on notes payable | (12,500) | (2,509,853) |

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| | | |
|--|------------|-------------|
| Principal payments on capitalized lease obligations . . . | (4,204) | (8,853) |
| Payments on notes payable - related party | (20,000) | (139,998) |
| Proceeds from issuance of common stock. | 72,139 | 425,942 |
| Proceeds from revolving credit facility | 523,300 | - |
| ----- | | |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES. | 558,735 | (2,232,762) |
| ----- | | |
| Net increase in cash | 389,892 | 183,208 |
| ----- | | |
| CASH AT BEGINNING OF PERIOD. | 592,006 | 27,648 |
| ----- | | |
| CASH AT END OF PERIOD. | \$ 981,898 | \$ 210,856 |
| ----- | | |

The accompanying notes are an integral part of these consolidated financial statements.

SPACEDEV, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONT'D.
(UNAUDITED)

Three-Months Ending March 31,

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the period for:

Interest

NONCASH INVESTING AND FINANCING ACTIVITIES:

During the three-months ending March 31, 2004 the Company issued 500,000 shares of its common stock to the Laurus Master Fund from conversions under its revolving credit facility, there realizing a corresponding reduction in current liabilities of approximately \$275,000. The recorded additional non-cash loan fees of approximately \$439,000 and charged these fees to

During the three-months ending March 31, 2004, the Company issued 70,035 shares of its common stock upon conversion of from employee stock options for \$40,700 in cash.

During the three-months ending March 31, 2004, the Company issued 7,076 shares of its common stock from the Company's Employee Stock Purchase Plan for approximately \$6,400 in cash.

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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1. BASIS OF PRESENTATION

The accompanying consolidated financial statements of SpaceDev, Inc. ("the Company") include the accounts of the Company and its inactive subsidiary, SpaceDev Oklahoma. In the opinion of management, the consolidated financial statements reflect all normal and recurring adjustments, which are necessary for a fair presentation of the Company's financial position, results of operations and cash flows as of the dates and for the periods presented. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Consequently, these statements do not include all disclosures normally required by generally accepted accounting principles of the United States of America for annual financial statements nor those normally made in an Annual Report on Form 10-KSB. Accordingly, reference should be made to the Company's Form 10-KSB filed on April 6, 2004 and other reports the Company filed with the U.S. Securities and Exchange Commission for additional disclosures, including a summary of the Company's accounting policies, which have not materially changed. The consolidated results of operations for the three-months ending March 31, 2004 are not necessarily indicative of results that may be expected for the fiscal year ending December 31, 2004 or any future period, and the Company makes no representations related thereto.

As of March 31, 2004, management continues the opinion that the Company's auditors, PKF, expressed in their formal auditors' opinion dated February 11, 2004 (except for Note 11 as to which the date is April 5, 2004), that in their opinion, based on their audit, the Company's consolidated financial statements referred to herein present fairly, in all material respects, the consolidated financial position of SPACEDEV, INC. AND SUBSIDIARY as of December 31, 2003, and the consolidated results of the Company's operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. The accompanying consolidated financial statements as of March 31, 2004 have been prepared assuming the Company will continue as a going concern. During the first three-months of 2004, the Company had a working capital deficit of \$294,344 and incurred a net loss of \$442,549 as compared to a working capital deficit of \$305,551 and a net loss of \$505,087 for the same three-month period in 2003. On March 31, 2004, the Company was awarded a \$43,362,271 contract from the Missile Defense Agency. Management still intends to obtain new commercial and government contracts, continue to utilize (and possibly expand) its revolving credit facility and possibly raise some additional debt or equity capital in a public or private offering or fund-raising effort. There can be no assurance that existing contracts will be completed successfully or that new contracts or additional debt or equity financing that may be needed to fund operations will be available or, if available, obtained in sufficient amounts necessary to meet the Company's needs. Management does believe that, if current contracts remain on schedule and are funded as expected, they will be sufficient to fund the Company through 2004.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the results of operations during the reporting period. Actual results could differ materially from those estimates.

Beginning in the second quarter of 2002, the Company's capitalized software costs were amortized over their estimated useful lives using the straight-line method. Periodically and at least annually, management performs a review for impairment in accordance with SFAS No. 144. During the three-months ended March 31, 2003, these capitalized software costs were \$34,503 leaving a balance of \$69,005, which was fully amortized in 2003.

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2. REVENUE RECOGNITION

The Company's revenues for the three-months ended March 31, 2004 were derived primarily from United States government cost plus fixed fee (CPFF) contracts compared to a predominance of fixed price contracts for the same three-months in 2003. Revenues from the CPFF contracts during the first three-months of 2004 were recognized as expenses were incurred compared to revenues from fixed price contracts for the same period in 2003, which were recognized using the percentage-of-completion method. Estimated contract profits are taken into earnings in proportion to revenues recorded. Revenues under certain long-term fixed price contracts, which provide for the delivery of minimal quantities or require significant amounts of development effort in relation to total contract value, are recorded upon achievement of performance milestones or using the cost-to-cost method of accounting where revenues and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. Time and material revenues are recognized as services are performed and costs incurred. Losses on contracts are recognized when estimated costs are reasonably determined. Actual results of contracts may differ from management's estimates and such differences could be material to the consolidated financial statements. Professional fees are billed to customers on a time and materials basis, a fixed price basis or a per-transaction basis depending on the terms and conditions of the specific contract. Time and material revenues are recognized as services are performed and costs incurred.

The total amount of costs in excess of billings and estimated earning was \$253,819 at March 31, 2003. There were no costs in excess of billing at March 31, 2004. Costs in excess of billings and estimated earning occur when costs incurred on projects exceed the allowed amount billed to the customer at that time and are booked as a temporary asset on the balance sheet.

Deferred revenue represents amounts collected from customers for projects, products or services to be provided at a future date.

In November 1999, the Space Missions Division was awarded a turnkey mission contract by the Space Sciences Laboratory at the University of California at Berkeley ("UCB") worth, as of December 31, 2002, approximately \$7.4 million, including change orders worth approximately \$514,000. This contract represented 14% of the Company's revenues for the year ending December 31, 2003. The contract concluded on December 31, 2003. CHIPSat continues to operate and UCB decided to extend the mission. On February 25, 2004, a new time and materials purchase order arrangement was initiated between the University of California at Berkeley and the Company.

3. NOTES PAYABLE

a) Building and Settlement Notes

In December 2002, the Company entered an agreement to sell its interest in its facility. The transaction closed in January 2003. The escrow transaction included the sale of the land and building. Net fixed assets were reduced by approximately \$1.9 million and notes payable were reduced by approximately \$2.4 million while a deferred gain was recorded. In conjunction with the sale, the Company entered into a lease agreement with the buyer to leaseback its facilities. The Company's Chief Executive Officer provided a guarantee for the leaseback. The gain on the sale of the facility was deferred and amortized in proportion to the gross rental charged to expense over the lease term. Deferred gain of \$1,172,720 is being amortized at the rate of \$117,272 per year for ten (10) years ending in January 2013. As of March 31, 2004, the deferred gain was \$1,035,903. This amortization will be included in the Company's occupancy and facility expense and totaled \$29,318 and \$19,545 for the three-months ending

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March 31, 2004 and 2003, respectively.

Deferred Gain consisted of the following:

Three-Months Ending March 31, 2004

| | |
|----------------------------------|-------------|
| Original Deferred Gain | \$1,172,720 |
| Less Amortization 2003 | (107,499) |
| Less Amortization 2004 | (29,318) |
| | \$1,035,903 |

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In 2001, the Company entered into three settlement loan agreements with various vendors. The total of \$171,402 for all three loans called for payment between 24 and 50 months with interest that ranges from 0% to 8%. At March 31, 2004 and 2003, the outstanding balances on these notes were \$75,091 and \$131,944, respectively, with interest expense for the three-months ending March 31, 2004 and 2003 of \$977 and \$1,394, respectively.

Future minimum principal payments on settlement notes are as follows:

Period Ended March 31,

| | |
|------------------------|----------|
| 2004 | \$37,961 |
| 2005 | 37,130 |
| 2006 | 0 |
| Total Settlement Notes | \$75,091 |

b) Related Parties

The Company has a note payable to the CEO. At March 31, 2004 and 2003, the balances were \$580,113 and \$608,364, respectively, with accrued interest or interest accruing at 10%. The note was amended on March 20, 2000 to call for annual payments of not less than \$80,000 per year with interest at 10%. The Company is currently making principle only payments on the note, with interest payments accruing and paid at the end of the note.

Future minimum principal payments on note payable, related parties are as follows:

Period Ending March 31,

| | |
|----------------|-----------|
| 2004 | \$ 80,000 |
| 2005 | 80,000 |

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| | |
|----------------------|-----------|
| 2006 | 80,000 |
| 2007 | 80,000 |
| 2008 | 80,000 |
| Thereafter | 180,113 |
| ----- | ----- |
| | \$580,113 |
| ----- | ----- |

Interest expense on this note was \$14,593 and \$9,866 for the three-months ended March 31, 2004 and 2003, respectively.

c) Revolving Credit Facility.

On June 3, 2003, the Company entered into a Security Agreement, Secured Convertible Note, Registration Rights Agreement and Common Stock Purchase Warrant, with Laurus Master Fund, Ltd. ("Laurus"), which were filed on Form 8-K dated June 18, 2003. Pursuant to the agreements, the Company received a \$1 million revolving credit facility in the form of a three-year Convertible Note secured by its assets. The net proceeds from the Convertible Note are used for general working capital needs. Advances on the Convertible Note may be repaid at the Company's option, in cash or through the issuance of the Company's shares of common stock. The Convertible Note carries an interest rate of WSJ Prime plus 0.75% on any outstanding balance. In addition, the Company is required to pay a collateral management payment of 0.55% of the average aggregate outstanding balance during the month plus an unused line payment of 0.20% per annum. Approximately \$1,700 in interest and \$2,100 in fees were accrued under the revolving credit facility in the first quarter of 2004. The outstanding balance on the revolving credit facility at March 31, 2004 was \$1,001,043.

The Company filed Form SB-2 on July 25, 2003 in connection with this transaction. The shares were registered with the Securities and Exchange Commission ("SEC") for public resale on August 6, 2003. Once the market price exceeded 118% of the fixed conversion price, which occurred on or about July 21, 2003, the Company obtained the ability to pay amounts outstanding under the revolving credit facility in cash or shares of its common stock at the fixed conversion price of \$0.55 per share on the first \$1 million of principal.

The Convertible Note includes a right of conversion in favor of Laurus. If Laurus exercises its conversion right at any time or from time to time at or prior to maturity, on any outstanding balance at the time, the Convertible Note is convertible into shares of the Company's common stock at a fixed conversion price, subject to adjustments for stock splits, combinations and dividends and for shares of common stock issued for less than the fixed conversion price (unless exempted pursuant to the agreements). The agreement was modified on March 31, 2004 to provide for a six-month waiver to us and a fixed conversion price to Laurus of \$0.85 per share on the first \$500,000 after the first \$1 million. Thereafter, the fixed conversion price will be adjusted after conversion of the first \$1.5 million to 103% of the then fair market value of our common stock ("Adjusted Fixed Conversion Price").

Laurus converted 500,000 shares to reduce the debt we owed by \$275,000 for the three-months ending March 31, 2004. Laurus converted a total of 915,000 shares to reduce the debt by \$503,250 since the inception of the revolving credit facility. For the three-months ending March 31, 2004, the Company expensed \$464,000 for the non-cash loan fee expense based on the fair market value of the stock when Laurus converted and approximately \$590,000 for the non-cash loan fee expense since the inception of the revolving credit facility. The fair market value used in 2003 was established using a 20% discount to the closing price on

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the date of conversion based on the restricted and thinly-traded nature of the Company stock in 2003 and the fair market value used in 2004 was established using the closing price on the date of conversion with no discount taken due to the increasing volume of the Company's stock.

Availability of funds under the revolving credit facility will be based on our accounts receivables, except as waivers are provided by Laurus. An initial three (3) month waiver was offered by Laurus, under which Laurus permitted a credit advance up to \$300,000, which amount would otherwise have exceeded eligible accounts receivable during the period. Laurus subsequently extended the waiver for two additional six (6) month periods, under which Laurus permitted a credit advance up to \$1 million, which amount would otherwise have exceeded eligible accounts receivable during the period. The revolving credit facility is secured by all of the assets of the Company.

In conjunction with this transaction, Laurus was paid a fee of \$20,000 for the first year which was expensed as additional interest expense in 2003. The Company will be required to pay a continuation fee of \$10,000 in June 2004 and each year thereafter. In addition, Laurus received a warrant to purchase 200,000 shares of the Company's common stock, as stated herein. The warrant exercise price is computed as follows: \$0.63 per share for the purchase of up to 125,000 shares; \$0.69 per share for the purchase of an additional 50,000 shares; and \$0.80 per share for the purchase of an additional 25,000 shares. The warrant exercise price may be paid in cash, in shares of the Company's common stock, or by a combination of both. The warrant expiration date is June 3, 2008. The warrant exercise price and the number of shares underlying the warrant are subject to adjustments for stock splits, combinations and dividends.

In addition to the initial warrant, the Company is obligated to issue an additional five-year warrant to Laurus to purchase one share of common stock at an exercise price equal to 125% of the Adjusted Fixed Conversion Price for every ten dollars (\$10) in principal of the Convertible Note converted into common stock if and when over \$1 million is converted under the revolving credit facility. The value of the warrant will be determined if and when issued, and will be treated as additional interest expense and will be amortized over the remaining term of the Convertible Note, unless sooner terminated. No more than an aggregate of 100,000 shares of the Company's common stock may be purchased by Laurus under such additional warrants.

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The Company may terminate its agreements with Laurus before the end of the initial three year term and Laurus will release its security interests upon payment to Laurus of all obligations, if the Company has: (i) provided Laurus with an executed release of all claims which the Company may have under the agreements; and, (ii) paid to Laurus an early payment fee in an amount equal to (x) four percent (4%) of the Capital Availability Amount if such payment occurs prior to the first anniversary of the Initial Term (i.e., June 3, 2004); (y) three percent (3%) of the Capital Availability Amount if such payment occurs after the first anniversary and prior to the second anniversary of the Initial Term; and, (z) two percent (2%) of the Capital Availability Amount if such payment occurs after the second anniversary and prior to the end of the Initial Term. The early payment fee is also due and payable by the Company to Laurus if the Company terminates its Agreement after the occurrence of an Event of Default, as define in the agreements.

4. CONVERTIBLE DEBT NOTES PAYABLE

From October 14, 2002 through November 14, 2002, the Company sold an aggregate of \$475,000 of 2.03% convertible debentures to various directors and officers of the Company. The total funding was completed on November 14, 2002. The

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convertible debentures entitled the holder to convert the principal and unpaid accrued interest into the Company's common stock when the notes matured. The maturity on the notes was six (6) months from issue date. On March 25, 2003, an amendment was executed which extended these notes an additional six (6) months. The convertible debentures were exercisable into a number of the Company's common shares at a conversion price that equals the 20-day average ask price less 10%, which was, established when the note was issued, or the initial conversion price.

Concurrent with the issuance of the convertible debentures, the Company issued warrants to purchase up to 1,229,705 shares of the Company's common stock to the subscribers. These warrants are exercisable for three (3) years from the date of issuance at the initial exercise price, which is equal to the 20-day average ask price less 10%, which was established when the notes were issued, or the initial conversion price of the notes. Upon issuance, the issued warrants were valued using the Black-Scholes pricing model based on the expected fair value at issuance and the estimated fair value was recorded as debt discount. As a result of the change to the maturity date of the convertible debt, the amortization period for the debt discounts was also extended during the first quarter in 2003.

All debt discounts are to be amortized as additional interest expense over the term of the convertible debenture. As of March 31, 2003, \$475,000 was reflected as debt discount of which \$100,455 was amortized to non-cash interest expense for the first three-months ending March 31, 2003. Fair market value of the stock was determined by discounting the closing market price on the date of the transaction by 20%, based on the nature of the restricted securities and thinly traded stock.

On September 5, 2003, the Company repaid one-half of the convertible notes, with the condition that the note holders convert the other half. Also, as a condition of the partial repayment, the note holders were required to relinquish one-half of the previously issued warrants. Finally, as additional consideration for the transaction, the note holders were offered 5% interest on their notes, rather than the stated 2.03%. All the note holders accepted the offer and the convertible notes were retired.

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Balances as of March 31, 2004 were:

| | | |
|--|--------------|------------|
| Convertible debentures - beginning balance | | \$ 475,000 |
| Total interest expense incurred. | \$ 20,236 | |
| Accrued interest paid - 2003 | \$ (18,161) | |
| Accrued interest paid - 2002 | \$ (2,075) | |
| Convertible debentures paid. | \$ (237,500) | |
| Convertible debentures converted to equity | \$ (237,500) | |
| | \$ (475,000) | |
| Convertible debentures - ending balance. | | \$ 0 |
| Debt discount (Warrants) - beginning balance . . . | | \$ 475,000 |
| Amount forfeited | \$ (237,500) | |
| Amount expensed - 2002 | \$ (125,000) | |
| Amount expensed - 2003 | \$ (267,879) | |

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| | | |
|---|--------------|------|
| 2003 - adjustment | \$ 155,379 | |
| ----- | | |
| | \$ (475,000) | |
| Debt discount (Warrants) - ending balance | | \$ 0 |
| ----- | | |

5. STOCKHOLDERS' EQUITY - COMMON STOCK AND WARRANTS

On November 5, 2000, the Company commenced a private placement offering ("PPO") for a maximum of 1,000,000 shares of the Company's \$0.0001 par value common stock and warrants to purchase an additional 1,000,000 shares of common stock (the "Units"). The offering price of the Units was the five-day average of the bid and ask prices for the Company's common stock on the date of issuance, with a minimum per Unit price of \$1.00. The warrants allowed the holder to acquire additional shares at \$0.50 above the offering price of the shares. The Company sold to one related-party investor under these terms.

On March 2, 2001, the PPO offering price was amended to the average of the high bid prices on the date of issuance and four preceding days, with no minimum per share price, and the warrants were amended to allow the holder to acquire additional shares at the Unit price.

On January 16, 2003 and February 14, 2003, pursuant to an extension of the PPO, the Company sold 665,188 and 196,079 Units, respectively. The Company received approximately \$326,000 and \$100,000, respectively, for the Units sold under the PPO during the first quarter 2003.

The Company has elected to account for its stock-based compensation plans under APB 25. However, the Company has computed, for pro forma disclosure purposes, the value of all options granted during the period ending March 31, 2004 and 2003 using the minimum value method as prescribed by SFAS 123 and amended by SFAS 148. Under this method, the Company used the risk-free interest rate at the date of grant, the expected volatility, the expected dividend yield and the expected life of the options to determine the fair value of options granted. The risk-free interest rates ranged from 6.0% to 6.5%, expected volatility of was 117%, the dividend yield was assumed to be zero, and the expected life of the options was assumed to be three to five years based on the average vesting period of options granted.

If the Company had accounted for these options in accordance with SFAS 123, the total value of options granted during the period ending March 31, 2004 and 2003 would be amortized on a pro forma basis over the vesting period of the options. Thus, the Company's consolidated net loss would have been as follows:

| Three-Months Ending March 31, | 2004 | 2003 |
|-------------------------------|--------------|--------------|
| ----- | ----- | ----- |
| Net loss: | | |
| ----- | ----- | ----- |
| As reported | \$ (442,549) | \$ (505,087) |
| Pro forma | \$ (534,614) | \$ (578,932) |
| Loss per Share: | | |
| ----- | ----- | ----- |
| As reported | \$ (.03) | \$ (.03) |

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Pro forma. \$ (.03) \$ (.04)

6. NEW ACCOUNTING PRONOUNCEMENTS

There were no recent Accounting Pronouncements that affect the Company during the first quarter 2004. For past pronouncements please refer the company's 10-KSB filed on April 6, 2004.

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

The following discussion should be read in conjunction with the Company's consolidated financial statements and the notes thereto and the other financial information appearing elsewhere in this document. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation our General Registration Statement on Form 10SB12G/A filed January 28, 2000 as well as any or all of our recent filings including prior year 10-KSB and quarterly 10-QSB filings.

In addition to historical information, the following discussion and other parts of this document may contain forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," or "continue," the negative of such terms or other comparable terminology. These statements are only predictions. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. We undertake no obligation to publicly update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

Actual results could differ materially from those anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, the level of sales to key customers; the economic conditions affecting our industry; actions by competitors; fluctuations in the price of raw materials; the availability of outside contractors at prices favorable to the Company; our dependence on single-source or a limited number of suppliers; our ability to protect our proprietary technology; market conditions influencing prices or pricing; an adverse outcome in potential litigation, claims and other actions by or against us; technological changes and introductions of new competing products; the current recession; terrorist attacks or acts of war, particularly given the acts of terrorism against the United States on September 11, 2001 and subsequent military responses by the United States and coalition forces; mission disasters such as the loss of the space shuttle Columbia on February 1, 2003 during its re-entry into earth's atmosphere; ability to retain key personnel; changes in market demand; exchange rates; productivity; weather; and market and economic conditions in the areas of the world in which we operate and market our products. These are factors that we think could cause our actual results to differ materially from expected and historical events.

OVERVIEW

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We are engaged in the conception, design, development, manufacture, integration and operation of space technology systems, products and services. We are currently focused on the commercial and military development of low cost micro satellites, nano satellites and related subsystems, hybrid rocket propulsion for space, launch and human flight vehicles as well as associated engineering and technical services primarily to government agencies, and specifically the Department of Defense. Our products and solutions are sold, mainly on a project-basis, directly to these customers and include sophisticated micro and nano satellites, hybrid rocket-based launch vehicles, Maneuvering and orbital Transfer Vehicles ("MoTVs") as well as safe sub-orbital and orbital hybrid rocket-based propulsion systems. Although we believe there will be a commercial market for our micro satellite and nano satellite products and services in the long-term, the early adopters of this technology appears to be government military agencies and our "products" are considered to be the outcome of specific "projects." We are also developing commercial hybrid rocket motors for possible use in small launch vehicles, targets and sounding rockets and small high performance space vehicles and subsystems for commercial customers.

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We were incorporated under the laws of the State of Colorado on December 23, 1996 as Pegasus Development Group, Inc. ("PDGI"). SpaceDev, LLC of Colorado was originally formed in 1997 for commercial space exploration and was the sole owner of shares of common stock of SpaceDev (a Nevada corporation) ("SpaceDev"), formed on August 22, 1997. On October 22, 1997, PDGI issued 8,245,000 of its \$.0001 par value common stock for 100 percent (1,000,000 shares) of SpaceDev's common stock owned by SpaceDev, LLC. Upon the acquisition of the SpaceDev stock, SpaceDev was merged into PDGI and, on December 17, 1997, PDGI changed its name to SPACEDEV, INC. After the merger, SpaceDev, LLC, changed its name to SD Holdings, LLC on December 17, 1997. We became a publicly traded company in October 1997 and are trading on the Nasdaq Over-the-Counter Bulletin Board ("OTCBB") under the symbol of "SPDV."

SELECTION OF SIGNIFICANT CONTRACTS

On March 31, 2004, we were awarded a five-year, cost-plus-fixed fee indefinite delivery/indefinite quantity contract for up to \$43,362,271 to conduct a micro satellite distributed sensing experiment, an option for a laser communications experiment, and other micro satellite studies and experiments as required in support of the Advanced Systems Deputate of the Missile Defense Agency. This effort will be accomplished in a phased approach. The total five-year contract has a ceiling amount of \$43,362,271. The principal place of performance will be Poway, California. We expect to complete the work under the contract before March 2009. Government contract funds will not expire at the end of the current government fiscal year. The micro satellite distributed sensing experiment is intended to design and build up to six responsive, affordable, high performance micro satellites to support national missile defense. The milestone-based, multiyear, multiphase contract has an effective start date of March 1, 2004. Approximately \$62,000 of revenue was accrued for work performed in March 2004 but not invoiced until April 2004 due to the late execution date of the contract. The first phase is expected to be completed this year and will result in detailed mission and microsat designs. The estimated first phase revenue is \$1.1 million. The overall contract calls for us to analyze, design, develop, fabricate, integrate, test, operate and support a networked cluster of three formation-flying boost phase and midcourse tracking microsatellites, with an option to design, develop, fabricate, integrate, test, operate and support a second cluster of three formation flying microsats to be networked on-orbit with high speed laser communications technology. The second phase is anticipated to begin on or before October 1, 2004 and run through 2005.

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On October 2, 2003, we were awarded an exclusive, follow-on contract to provide the hybrid rocket motor systems and components for SpaceShipOne. We provide our facilities, resources and a team of launch vehicle and hybrid propulsion engineers and technical personnel in continued support of the SpaceShipOne program. The contract called for us to use our best efforts to satisfy the requirements of the SpaceShipOne program, based on our experience with the prior phases. We are to provide two sets of re-usable flight test hardware, including a bulkhead, commonly known as the SpaceDev bulkhead, machined in the flight configuration, a main oxidizer valve of the current design and associated interfaces and plumbing to the SpaceDev bulkhead, a motor control system, igniter housings, pressure transducers, and thermocouples as required for input to the motor control system. In addition, we will produce and assemble test motors, including but not limited to, all expendable or semi-reusable materials as defined by our baseline design motor. We are also required to provide on-site engineering test support and post-test analysis. Provisions are made in the contract for minimum monthly payments in the event of customer schedule slippage as well as additional levels of support via engineering change orders, if required. The total contract value is estimated at \$429,000. Approximately \$106,000 of revenue was realized in the three-months ending March 31, 2004, with approximately \$63,000 from engineering change orders and the remaining \$43,000 from the contract.

Also on July 9, 2003, we were awarded a second contract by the Missile Defense Agency ("MDA") to explore the use of micro-satellites ("microsats") in national missile defense. Our microsats are operated over the Internet and are capable of pointing and tracking targets in space or on the ground. This study explored fast response microsat launch and commissioning; small, low-power passive sensors; target acquisition and tracking; formation flying and local area networking within a cluster of microsats; and an extension of our proven use of the Internet for on-orbit command, control and data handling. The contract was successfully concluded on February 27, 2004. The total contract value was \$800,000 with approximately \$319,000 of revenue realized in the three-months ending March 31, 2004. The total value of our microsatellite studies for MDA was over \$1 million in 2003. This second contract was considered an investigatory phase by MDA.

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On July 9, 2003, we were awarded a Phase I Small Business Innovation Research ("SBIR") contract by Air Force Research Lab ("AFRL") to design and begin the development of the SpaceDev Streaker(TM) small launch vehicle ("SLV"). SpaceDev Streaker(TM) will be designed to responsively and affordably lift up to 1,000 pounds to Low Earth Orbit ("LEO"). The SpaceDev Streaker(TM) SLV concept is based on a proprietary combination of technologies to increase the performance of hybrid rocket motor technology. Hybrid rocket motors are a combination of solid fuel and liquid oxidizer, and can be relatively safe, clean, non-explosive, and storable, and can be throttled, shut down and restarted. This contract is valued at approximately \$100,000, is a fixed price, milestone-based agreement, which should be completed within one year. We believe that this SBIR will move into Phase II valued at approximately \$750,000 of carry-forward work for us, plus an additional \$750,000 of funds provided by Congress based on discussions with the Air Force Research Laboratory technical personnel. This money will be used to develop and test fire our large Common Core Booster for the SpaceDev Streaker(TM) launch vehicle. We believe that there may be some interest by Congress in providing additional matching funding to expand and accelerate the scope of the work; however, there can be no assurance that such work will be awarded to us. Revenues for the three-months ending March 31, 2004 were approximately \$30,000.

On July 9, 2003, we were awarded a Phase I contract to develop micro- and nano-satellite bus and subsystem designs. This AFRL SBIR contract, valued at

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approximately \$100,000, will enable us to explore the further miniaturization of our unique and innovative microsat subsystems. It will also enable us to explore ways to reduce the time and cost to build small satellites through further standardization in order to help define de facto standards for payload hardware and software interfaces. The contract is fixed price, milestone-based and should be completed within one year. We believe that this SBIR will move into Phase II valued at approximately \$750,000 of carry-forward work for us; however, there can be no assurance that such work will be awarded to us. Revenues for the three-months ending March 31, 2004 were approximately \$24,000.

On December 18, 2003, we were awarded a contract by the Defense Advanced Research Projects Agency ("DARPA") for the study of Novel Satcom Microsat Constellation Deployment. The contract is a milestone-based, fixed price contract with total consideration of approximately \$200,000. Revenues for the three-months ending March 31, 2004 were approximately \$91,000. We expect to either expand this award or obtain new awards under this program; however, there can be no assurance as to whether such work will be awarded to us or, if it is, the amounts or terms of the awards.

On April 30, 2002, we were awarded Phase I of a contract to develop a Shuttle-compatible propulsion module for the AFRL. We received an award for Phase II of the contract on March 28, 2003, and will use the project to further expand our product line to satisfy commercial and government space transportation requirements. The first two phases of the contract (including an additional add-on option) are worth up to approximately \$2.5 million, of which \$100,000 was awarded for Phase I, and approximately \$1.4 million was awarded for Phase II. AFRL Phase II is a cost-plus fixed fee contract. We anticipate that to complete AFRL Phase II, approximately four months of additional time and approximately \$240,000 of additional funding will be required. We are currently negotiating with AFRL for the extension of Phase II in order to complete the work, which we anticipate will be granted in the second quarter of 2004. In addition to the Phase I and Phase II awards, there is an option worth approximately \$1 million pending initiation. The option has been awarded and work will begin once certain milestones are met to the satisfaction of the AFRL project manager. The additional funding to complete AFRL Phase II may come from the \$1 million option; thereby, requiring a reduction in the original scope of the option. Revenues for the three-months ending March 31, 2004 were approximately \$412,000 for AFRL Phase II.

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In November 1999, we won a \$4.9 million turnkey mission contract by the Space Sciences Laboratory ("SSL") at UCB. We were competitively selected by UCB/SSL to design, build, integrate, test and operate, for one year, a small NASA-sponsored scientific, Earth-orbiting spacecraft called CHIPSat. CHIPSat is the first and only successful mission of NASA's low-cost University-Class Explorer ("UNEX") series to date. CHIPSat launched as a secondary payload on a Delta-II rocket on January 12, 2003. The satellite achieved 3-axis stabilization, meaning it was pointing and tracking properly, with all individual components and systems successfully operating, and is continuing to work well in orbit after one year. In 2000, we reviewed the contract status at year-end and determined that the total estimated costs at the end of the program would exceed the likely revenue. As a result, we accrued a loss of approximately \$860,000 based on the expected contract modification of \$600,000, which was approved on June 15, 2001. On November 28, 2001, a second contract modification was signed with UCB, which added approximately \$1.2 million to the contract as well as an increase in contract scope. This increased the total contract revenue to approximately \$6.8 million and reduced the total expected loss on the contract to approximately \$460,000. During 2002, an additional contract modification for approximately \$400,000 was signed, which also increased the contract value and increased the scope of the contract to the

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current value of the CHIPSat project of approximately \$7.4 million, thereby increasing the total expected loss to approximately \$514,000. In retrospect, some of the CHIPSat expenses creating the loss could have been recorded as research and development costs associated with our ongoing satellite design and development programs. As of December 31, 2003, the total contract costs were expended, mainly as cost of goods sold. The original support contract expired on December 31, 2003. CHIPSat is still operating successfully and providing UCB with new and interesting data. UCB requested to extend the program and we recently negotiated a new time and materials contract in the form of a purchase order with UCB for continuing support of this project. Revenues for the three-months ending March 31, 2004 and 2003 were approximately \$12,000 and \$112,000, respectively.

RESULTS OF OPERATIONS

Please refer to the consolidated financial statements, which are a part of this report, for further information regarding the results of operations.

Three-Months Ending March 31, 2004 -vs.- Three-Months Ending March 31, 2003

During the three-months ending March 31, 2004, we had net sales of approximately \$1,015,000 as compared to net sales of approximately \$533,000 for the same three-month period in 2003, an increase of over 90%. Sales increased primarily due to the addition and expansion of government contacts such as those for AFRL and MDA, which created new revenue opportunities for us. Revenues in the three-months ending March 31, 2004 were comprised of approximately \$412,000 from AFRL Phase II, \$319,000 from MDA Phase II, \$106,000 from the new exclusive proprietary propulsion contracts (SpaceShipOne), \$91,000 from our DARPA contract, \$54,000 from the two SBIR contracts listed above, and \$33,000 from all other programs. During the same period of 2003, sales were comprised of approximately \$237,000 from the SpaceShipOne contract, \$157,000 from the MDA project, \$112,000 from the CHIPSat program, \$20,000 from Phase I of the AFRL project and approximately \$7,000 from all other programs.

For the three-months ending March 31, 2004, we had costs of sales (direct and allocated costs associated with individual contracts) of approximately \$807,500, or 79.6% of net sales, as compared to approximately \$462,000 or 86.6% of net sales, during the same period in 2003. The increase in cost of sales was primarily due to higher revenues since the majority of our current contracts are cost plus fixed fee contracts as well as the implementation of stronger cost controls and project monitoring. We continue to focus efforts on developing project management skills and reports to assist in the efficient and effective management of our projects. The gross margin percentage for the three-months ending March 31, 2004 was 20.4% of net sales, an increase of 7% of net sales, as compared to 13.4% of net sales for the same three-month period in 2003.

We experienced a decrease of approximately \$240,000 in operating expenses from approximately \$435,000, or 81.6% of net sales, for the three-months ending March 31, 2003 to approximately \$195,000 or 19.2% of net sales, for the three-months ending March 31, 2004. Operating expenses include general and administrative expenses ("G&A"), marketing and sales expenses and research and development expenses as well as stock and stock option based compensation expenses. Fluctuations in operating expenses for 2004 from 2003 are primarily attributable to the following:

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- Marketing and sales expenses increased during the first three-month of 2004 compared to the same period in 2003. The increase in marketing and sales expense, from approximately \$65,000, or 12.2% of net sales, for the three months ending March 31, 2003, to approximately \$99,000, or 9.8% of net sales, during

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the same period in 2004, mainly due to our decision to expand our marketing and sales department.

- Research and development ("R&D") expenses increased during the first three-months of 2004 from no research and development costs in 2003 to approximately \$15,000 or 1.5% of net sales for the three-months ending March 31, 2004.

- The decrease of approximately \$289,000 in G&A expenses from approximately \$370,000 for the three-months ending March 31, 2003 to approximately \$81,000 for the same three month period in 2004 was primarily due to software amortization expense of \$34,500 during the first quarter of 2003, which is no longer present in 2004 as well as a more appropriate classification of certain expenses into cost of goods sold.

Non-operating expense (income) consists of interest expense, non-cash debt discount expense and deferred gain on the sale of our building, as well as, other loan fees and expenses.

- Interest expense for the three-months ending March 31, 2004 and 2003 was approximately \$19,800, or 2.0% of net sales, and \$20,400, or 3.8% of net sales, respectively. The slight decrease was due to lower interest rates and a reduction in settlement notes and capital leases. Interest expense is comprised of interest on our note to our CEO, interest on our revolving credit facility/convertible debt and interest on our settlement notes/capital leases. For the three-months ending March 31, 2004 and 2003, interest expense on our note to our CEO was \$14,600 and \$10,000, respectively. For the three-months ending March 31, 2004 and 2003, interest expense on our revolving credit facility/convertible debt was \$4,000 and \$2,400, respectively. And interest expense on our settlement notes/capital leases for the three-month period ending March 31, 2004 and 2003 were \$1,200 and \$8,000, respectively.

- We recognized approximately \$29,300 and \$19,500 of the deferred gain on the sale of the building during the three-months ending March 31, 2004 and 2003, respectively, and we will continue to amortize the remaining deferred gain of approximately \$1,036,000 into non-operating income over the remainder of the lease. In relation to the gain we received on the building, we also accrued an income tax payable expense of \$40,000 at March 31, 2003 of which none remained at December 31, 2003. The reduction of the income tax payable was due to a change in estimate based on the loss we experienced during the year.

- During the three-months ending March 31, 2003, we expensed in conjunction with our convertible notes, part of the existing convertible debt discount related to warrants that accompanied the convertible debt issue in 2002 of approximately \$475,000, of which approximately \$100,000 was expensed during the three-months ended March 31, 2003 and paid or converted in September 2003. There was no debt discount for the first three-months of 2004.

- We realized loan fees related to our revolving credit facility and expenses related to the conversion of notes to common stock below fair market value of approximately \$464,000 for the three-months ending March 31, 2004. We accrued approximately \$4,000 of interest for the three-months ending March 31, 2004. We anticipate additional expenses related to similar note to equity conversions.

During the three-months ending March 31, 2004, we incurred a net loss of approximately \$442,500, or 43.6% of net sales, compared to a net loss of approximately \$505,000, or 94.8% of net sales, for the same three-month period in 2003. During the three-months ending March 31, 2004, we incurred an EBITDA (earnings before interest taxes depreciation and amortization) of approximately \$28,000, or 2.7% of net sales, compared to an EBITDA loss of approximately