SPACEDEV INC
Form SB-2
June 23, 2004

As filed with the Securities and Exchange Commission on June 22, 2004.

Registration Statement No. _____

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM SB-2
REGISTRATION STATEMENT
UNDER THE SECURITIES ACT OF 1933

SPACEDEV, INC.
(Exact name of registrant as specified in its charter)

COLORADO	3761	84-1374613
(State or other jurisdiction of incorporation or organization)	(Primary standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

13855 STOWE DRIVE
POWAY, CALIFORNIA 92064
(858) 375-2000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

JAMES W. BENSON
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER
SPACEDEV, INC.
13855 STOWE DRIVE
POWAY, CALIFORNIA 92064
(858) 375-2020
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:
GRETCHEN COWEN, ESQ.
WEINTRAUB DILLON PC
12520 HIGH BLUFF DRIVE, SUITE 260
SAN DIEGO, CALIFORNIA 92130
(858) 259-2529

Approximate date of commencement of proposed sale to public: FROM TIME TO TIME AFTER THE EFFECTIVE DATE OF THIS REGISTRATION STATEMENT.

PAGE

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box: | |

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, please check the following box: |X|

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: | |

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: | |

If delivery of the prospectus is expected to be made pursuant to Rule 434 under the Securities Act, please check the following box: | |

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF. . . . . SECURITIES TO BE REGISTERED . .	PROPOSED MAXIMUM AMOUNT TO BE REGISTERED (1)	PROPOSED MAXIMUM OFFERING PRICE PER SHARE	AGGREGA OFFERING PRICE	AMOUNT REGISTRAT
Common Stock, $0.001 par value, underlying Convertible Note . .	588,235(2)	$0.8500(3)	500,000	$63
Common Stock, $0.001 par value, underlying Warrants	337,838	$0.3700(3)	125,000	$15
Common Stock, $0.001 par value, underlying Warrants	128,205	$0.3900(3)	50,000	$6
Common Stock, $0.001 par value, underlying Warrants	148,810	$0.4200(3)	62,500	$7
Common Stock, $0.001 par value, underlying Warrants	50,000	$1.0625(3)	53,125	$6
Total	1,253,088		790,625	$100

(1) In the event of a stock split, stock dividend, or similar transaction involving common stock of the registrant, in order to prevent dilution, the number of shares registered shall be automatically increased to cover the additional shares in accordance with Rule 416(a) under the Securities Act. This registration statement covers an aggregate of 1,253,088 shares.

(2) Represents 100% of the good faith estimate of the number of shares that are issuable to the selling security holder following the conversion of interest on and/or principal of a convertible note held by the selling security holder. If our good faith estimate is incorrect and we determine that additional common stock will be required to cover all principal and interest payments, we will be required to file a new registration statement to register any such additional shares.

(3) Exercise prices fixed in each warrant agreement.

PAGE ii

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING UNDER SECTION 8(a), MAY DETERMINE.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. THE SELLING SECURITY HOLDERS IDENTIFIED IN THIS PROSPECTUS MAY NOT SELL SECURITIES UNDER THIS PROSPECTUS UNTIL THE REGISTRATION STATEMENT OF WHICH THIS PROSPECTUS IS A PART BECOMES EFFECTIVE.

SUBJECT TO COMPLETION, DATED JUNE 22, 2004.

PAGE iii

PROSPECTUS

SPACEDEV, INC.

1,253,088 SHARES OF COMMON STOCK

This prospectus relates to the resale by security holders of up to 1,253,088 shares of our common stock underlying (1) common stock purchase warrants for up to 614,853 shares issued to accredited investors in relation to Convertible Notes, (2) a three-year secured convertible note, or the Convertible Note, issued to Laurus Master Fund, Ltd. ("Laurus") in the principal amount of $500,000 representing 588,235 shares, and (3) a common stock purchase warrant for up to 50,000 shares issued to Laurus on June 22, 2004. We will not receive any of the proceeds from the sale of the shares by the selling security holders. We have not retained any underwriter in connection with the sale of the securities. We have paid, on behalf of the selling security holders, the expenses of the offering estimated to be $16,064.

Our common stock trades on The Over-the-Counter Bulletin Board under the symbol "SPDV." The last reported sale price of our common stock on June 11, 2004, was $1.51 per share.

Our principal offices are located at 13855 Stowe Drive, Poway, California 92064, and our telephone number is (858) 375-2030.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS. AS YOU REVIEW THE PROSPECTUS, YOU SHOULD CAREFULLY CONSIDER THE MATTERS DESCRIBED UNDER "RISK FACTORS" BEGINNING ON PAGE 7.

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS ACCURATE OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A

CRIMINAL OFFENSE.

THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

The date of this prospectus is June 22, 2004.

TABLE OF CONTENTS

PAGE 2

PAGE 3

PROSPECTUS SUMMARY

This summary highlights some information from this prospectus. Because it is a summary, it necessarily does not contain all of the information necessary to your investment decision. To understand this offering fully, you should read carefully the entire prospectus, especially the risks of investing in our common stock discussed under "Risk Factors."

In connection with a strategic financing with Laurus Master Fund, Ltd., or simply Laurus, this prospectus covers the resale of up to 588,235 shares of our common stock that are issuable upon conversion of a three-year Secured Convertible Note (the "Convertible Note"), in the principal amount of $500,000. In addition, this prospectus covers the resale of up to 50,000 shares of common stock issuable upon exercise of outstanding warrants issued to Laurus (the "Laurus Warrant"), and 614,853 shares of common stock issuable upon exercise of outstanding warrants issued to officers, directors and a former officer of the Company in an additional convertible note program November 2002 to June 2003 (collectively referred to herein as the "Warrants").

OUR COMPANY

We are engaged in the conception, design, development, manufacture, integration and operations of space technology systems, products and services. We are currently focused on the commercial development of low-cost microsatellites, nanosatellites and related subsystems, and hybrid rocket propulsion as well as the associated engineering technical services to government, aerospace and other commercial enterprises. Our products and solutions are sold directly to these customers and include sophisticated micro- and nanosatellites, hybrid rocket-based orbital Maneuvering and orbital Transfer Vehicles as well as safe sub-orbital and orbital hybrid rocket-based propulsion systems. We are also developing commercial hybrid rocket motors and small high performance space vehicles and subsystems. See "Description of Business" for more information.

THE OFFERING

Common stock underlying the interest and/or principal of the Convertible Note	588,235 shares
Common stock underlying the LaurusWarrant	50,000 shares
Common stock underlying the Warrants	614,853 shares
Common Stock Outstanding after Exercise of outstanding Warrants, the Laurus Warrant and the Convertible Note	19,478,307 shares

PAGE 4

Termination of the Offering	The offering will conclude upon the earlier of the sale of all 1,253,088 shares of common stock registered, the date the shares no longer need to be registered to be sold or the three-year anniversary of the effective date

	of the registration statement of which this prospectus is a part.
Use of Proceeds	All proceeds from the sale of shares underlying the Warrants, the Convertible Note and the Laurus Warrant will be received by the selling security holders for their own accounts. See "Use of Proceeds."
Risk Factors	You should read the "Risk Factors" beginning on page 7, as well as other cautionary statements throughout this prospectus, before investing in shares of our common stock.

SELECTED CONSOLIDATED FINANCIAL DATA

The following financial data is provided as of and for the fiscal years ended December 31, 2003 and 2002 and as of and for the three-months ending March 31, 2004 and 2003. The financial data as of and for the fiscal years ending December 31, 2003 and 2002 is derived from, and is qualified by reference to, the audited consolidated financial statements and the notes to those consolidated financial statements which are a part of this prospectus. The financial data as of and for the three-months ending March 31, 2004 and 2003 is derived from, and is qualified by reference to, unaudited consolidated financial statements, which are a part of this prospectus. In the opinion of our management, those unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial data as of and for the three-months ending March 31, 2004 and 2003. Our historical results are not necessarily indicative of results to be expected for any future periods.

SELECTED CONSOLIDATED STATEMENTS OF OPERATIONS DATA:

	YEARS ENDING DECEMBER 31, (Audited)		THREE
	2003	2002	2
Net revenues	$ 2,956,322	$ 3,370,118	$ 1,014,
Profit (Loss) from operations.	$ (890,092)	$ 13,920	$ 11,
Net loss	$ (1,246,067)	$ (376,160)	$ (442,
Basic loss per share	$ (0.08)	$ (0.03)	$ (0
Weighted average shares outstanding, basic	16,092,292	14,744,423	16,839,

SELECTED CONSOLIDATED BALANCE SHEET DATA:

	DECEMBER 31,	MARCH 31,

	(Audited)		(Unaudited)	
	2003	2002	2004	
Cash and cash equivalents	$ 592,006	$ 27,648	$ 981,898	$ 2
Working capital deficit	($630,805)	($197,381)	($294,344)	($3
Total assets.	$ 1,084,819	$ 3,811,957	$ 1,595,829	$ 9
Long-term debt, net of current portion. .	$ 556,902	$ 661,314	$ 541,612	$ 6
Stockholders' Deficit	($2,072,628)	($1,767,459)	($1,704,038)	($1,8

RISK FACTORS

AN INVESTMENT IN SHARES OF OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. IN ADDITION TO THE OTHER INFORMATION CONTAINED IN THIS PROSPECTUS, YOU SHOULD CAREFULLY CONSIDER THE FOLLOWING RISK FACTORS BEFORE DECIDING TO INVEST OR MAINTAIN AN INVESTMENT IN SHARES OF OUR COMMON STOCK. THIS PROSPECTUS CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF CERTAIN FACTORS, INCLUDING THOSE SET FORTH IN THE FOLLOWING RISK FACTORS AND ELSEWHERE IN THIS PROSPECTUS. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCURS, IT IS LIKELY THAT OUR BUSINESS, FINANCIAL CONDITION AND OPERATING RESULTS WOULD BE HARMED. AS A RESULT, THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE, AND YOU COULD LOSE PART OR ALL OF YOUR INVESTMENT.

OUR PLAN TO REMAIN CASH FLOW POSITIVE AND BECOME PROFITABLE DEPENDS ON OUR ABILITY TO INCREASE REVENUES, WHILE CONTROLLING COSTS IN A VARIETY OF AREAS, AS WELL AS, IMPROVE OUR PROJECT MANAGEMENT EXPERTISE.

Our auditors, PKF, expressed in their formal auditors' opinion dated February 11, 2004 (except for Note 1 as to which the date is April 2, 2004) that in their opinion, based on their audit, our consolidated financial statements referred to herein present fairly, in all material respects, the consolidated financial position of SpaceDev, Inc. and its subsidiary as of December 31, 2003, and the consolidated results of our operations and our cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. In addition, we have recorded two consecutive quarters of positive cash flow and one quarter of operating profit. However, in previous years, including the opinion of Nation Smith dated February 13, 2003 herein, our auditors expressed an opinion that our financial position raised substantial doubt about our ability to continue as a going concern.

After an analysis of our newly awarded $43,362,271 contract from the Missile Defense Agency, our projections (including revenue projections) for the next several quarters and other relevant factors, our auditors concluded there is no longer substantial doubt as to the Company's ability to continue as a going concern, and has, therefore, not included the going concern language in its report dated February 11, 2004 (except for Note 11 as to which the date is April 2, 2004) for the year ended December 31, 2003. We believe that this was appropriate and reflects our improved financial condition, our ability to forecast more accurately and further validation of customer demand for our technology, products and services. However, our ability to continue as a going concern depends upon our ability to ultimately implement our plans, which includes (but is not limited to) generating substantial new revenue from the Missile Defense Agency by successfully performing under the newly awarded contract and continuing to attract and successfully complete other government and commercial contracts, development of a project management expertise to profitably execute on new business contracts and reduce the working capital deficit by raising additional capital.

We are working with our revolving credit facility provider and investigating the possibility of raising additional capital to further support operations as new contracts and business opportunities materialize. The prospective funding, as well as, new business opportunities, can come from a variety of sources, including public or private equity markets, state and federal grants and government and commercial customer program funding. However, there can be no assurance that we will be able to obtain such funding or contracts as needed or, if such funding or contracts are available, that we can obtain then on terms favorable to the Company. The likelihood of our success must be considered in light of the expenses, difficulties and delays frequently encountered in connection with the developing businesses, those historically encountered by us, and the competitive environment in which we operate.

IF WE ARE UNABLE TO RAISE CAPITAL IN THE FUTURE, WE MAY BE UNABLE TO FUND OPERATING CASH SHORTFALLS.

Our future capital requirements will depend upon many factors, including but not limited to sales and marketing efforts, the development of new products and services, the successful completion of existing projects, possible future strategic acquisitions, the progress of our research and development efforts, and the status of competitive products and services. As of March 31, 2004, December 31, 2003 and 2002, we had a working capital deficit of $294,344, $630,805 and $197,381, respectively, and an accumulated deficit of $12,260,325, $11,817,776, and $10,571,709, respectively. As of those dates, we had $981,898, $592,006 and $27,648, respectively, in cash and cash equivalents and $296,980, $187,062 and $82,325, respectively, of accounts receivable, net of allowance for doubtful accounts.

We believe that current and future available capital resources will be adequate to fund our operations for the next twelve (12) months. However, historically we have not been able to generate sufficient cash from our operating activities and have relied upon cash from financing activities to fund part of the cash requirements of our operating and investing activities. To the extent we are in need of any additional financing, it may not be available to us on acceptable terms, or at all. Our inability to obtain any needed financing could result in a significant loss of ownership and/or control of our proprietary technology and other important assets and could also hinder our ability to fund our continued operations and our product development efforts that historically have contributed significantly to our competitiveness.

Any financing may cause significant dilution to existing stockholders. Any debt financing or other financing of securities senior to common stock likely will include financial and other covenants that will restrict our flexibility. At a minimum, we expect these covenants to include restrictions on our ability to pay dividends on our common stock.

SOME OF OUR GOVERNMENT CONTRACTS ARE STAGED AND WE CANNOT GUARANTEE THAT ALL STAGES OF THE CONTRACTS WILL BE AWARDED TO US OR AT ALL.

Some of our government contracts, including our newly awarded $43,362,271 MDA contract, are phased contracts, in which the customer may determine to terminate the contract between phases for any reason. We can give no assurance that, as to any such agreement, the entire contract will be realized by us. In the event that subsequent phases of some of our government contracts, including but not limited to the MDA contract, are not awarded to us, it would have a material adverse effect on our business operations and financial condition, unless equivalent contracts were simultaneously awarded to us.

IF A SIGNIFICANT PORTION OF THE CONVERTIBLE NOTE OR THE WARRANTS WERE CONVERTED INTO SHARES OF OUR COMMON STOCK, THE VOTING POWER OF YOUR INVESTMENT AND OUR EARNINGS PER SHARE COULD BE DILUTED.

The Convertible Note in the amount of $1,000,000, that we issued to Laurus, on June 3, 2003, was converted by Laurus into 1,818,182 shares of our common stock at an initial fixed conversion price of $0.55 per share. Under this filing, the Convertible Note may be converted into up to 588,235 shares of our common stock at a fixed conversion price of $0.85 per share, to the extent that we draw funds on the credit facility and have not repaid those funds. The 588,235 shares represent approximately 3% of the 18,225,219 shares of our common stock outstanding on June 11, 2004. As a result, if the 588,235 shares underlying the Convertible Note were converted at the fixed conversion price stated above, dilution of the voting power of your investment and of our earnings per share could continue to occur. Furthermore, after the conversion by Laurus of the $500,000, or 588,235 shares, Laurus has a continuing right to convert, to the extent that we draw funds on the credit facility and have not repaid those funds, at a fixed conversion price based on a fair market value formula specified in the agreement.

In addition, the Laurus Warrant and the Warrants each may be exercised for a per share price that is lower than the current fair market value of our common stock as traded on the Over-The-Counter Bulletin Board. Although the exercise of those warrants will result in proceeds to the Company, significant dilution of the voting power of your investment and of our earnings per share could occur.

THE MARKET PRICE OF OUR COMMON STOCK AND THE VALUE OF YOUR INVESTMENT COULD SUBSTANTIALLY DECLINE IF ALL OR A SIGNIFICANT PORTION OF THE CONVERTIBLE NOTE WERE CONVERTED INTO COMMON SHARES WHICH WERE RESOLD INTO THE MARKET, OR IF A PERCEPTION EXISTS THAT SUCH SALES COULD OCCUR.

If the conversion prices at which the Convertible Note is converted, or the exercise prices on the Laurus Warrant and the Warrants, are lower than the price at which you made your investment, immediate dilution of the value of your investment will occur. In addition, sales of a substantial number of shares of common stock issued upon conversion of the Convertible Note or exercise of the warrants, or even the perception that such sales could occur, could adversely affect the market price of our common stock. You could, therefore, experience a decline in the value of your investment as a result of both the actual and potential conversion of Convertible Note and/or the exercise of the Warrants.

NO ASSURANCE OF SUCCESSFUL OR TIMELY DEVELOPMENT OF PRODUCTS.

Despite our success in designing, launching and monitoring our first microsatellite, our products and technologies are currently under various stages of development, including our hybrid rocket technology. Further development and testing will be required to prove additional performance capability beyond current tests and commercial viability. Additionally, the final cost of development cannot be determined until development is complete. The success, if any, will depend on the ability to timely complete our projects within estimated cost parameters and ultimately deploy the product in a cost-effective manner.

THE MARKETPLACE FOR OUR TECHNOLOGY AND PRODUCTS IS UNCERTAIN.

There can be no assurance that there will be a demand for our technology, products and services or that we will be successful in obtaining a sufficient market share to sustain our business or to achieve profitable operations. Our business plan is based on the assumption that significant revenues will be

generated in connection with the government being early adopters and deploying microsatellites in the near-term with a long-term commercial market developing for private manned and unmanned space exploration. Because microsatellites and commercial space exploration are still relatively new concepts, it is difficult to accurately predict the ultimate size of the market. We have a limited prior operating history, and there can be no assurance that we will increase our revenues and become profitable. Additionally, if either the demand for our products produced or services rendered or if general economic conditions deteriorate significantly, our business could be impacted to a substantial degree resulting in lower profitability or losses as a direct result. Many of our products and services are new and unproven, and the true level of consumer demand is uncertain. Lack of significant market acceptance of our products and services, delays in such acceptance, or failure of markets to develop could negatively affect our business, financial condition, and results of operations. Many of the factors, which affect us, and our business, are dictated by the marketplace and are beyond our control.

CONTRACTUAL LIMITATIONS THAT RESTRICT LAURUS' ABILITY TO CONVERT THE CONVERTIBLE NOTE MAY NOT NECESSARILY PREVENT SUBSTANTIAL DILUTION OF THE VOTING POWER AND VALUE OF YOUR INVESTMENT.

Laurus may convert the Convertible Note into shares of our common stock to the extent that a balance exists on the revolving credit facility. Currently, there is no balance on the revolving credit facility and we have sufficient cash to fund operations; however, the contractual limitations that restrict Laurus' ability to convert the Convertible Note into shares of our common stock are limited in their application and effect and may not prevent dilution of your investment and we cannot be assured that additional draws on the revolving credit facility will not be required in the future. Laurus is subject to a contractual 4.99% beneficial ownership limitation that prohibits Laurus from converting the note if and to the extent that the conversion would result in Laurus, together with its affiliates, beneficially owning more than 4.99% of our outstanding common stock. However, this 4.99% limitation automatically becomes void upon an event of default under the Note and can be waived by Laurus upon 75 days' advance notice to us. In addition, this 4.99% limitation does not prevent Laurus from converting the note into shares of common stock and then reselling those shares in stages over time where Laurus and its affiliates do not, at any given time, beneficially own shares in excess of the 4.99% limitation. Consequently, these limitations will not necessarily prevent dilution of the voting power and value of your investment.

BECAUSE OUR STOCK IS SUBJECT TO THE SEC'S PENNY STOCK RULES, BROKER-DEALERS MAY EXPERIENCE DIFFICULTY IN COMPLETING CUSTOMER TRANSACTIONS AND TRADING ACTIVITY IN OUR SECURITIES MAY BE ADVERSELY AFFECTED.

Because we currently have less than $5,000,000 in net tangible assets and the market price of our common stock is less than $5.00 per share, transactions in our common stock are subject to the "penny stock" rules promulgated under the Securities Exchange Act of 1934. Under these rules, broker-dealers who recommend our securities to persons other than institutional accredited investors:

- must make a special written suitability determination for the purchaser;
- receive the purchaser's written agreement to a transaction prior to sale;
- provide the purchaser with risk disclosure documents which identify certain risks associated with investing in "penny stocks" and which describe the market for these "penny stocks" as well as a purchaser's legal remedies; and
- obtain a signed and dated acknowledgment from the purchaser demonstrating that the purchaser has actually received the required risk disclosure

document before a transaction in a "penny stock" can be completed.

As a result of these rules, broker-dealers may find it difficult to effectuate customer transactions and trading activity in our securities may be adversely affected. As a result, the market price of our securities may be depressed, and you may find it more difficult to sell our securities.

IF WE ARE UNSUCCESSFUL IN ACHIEVING AND MAINTAINING COMPLIANCE WITH OUR REGISTRATION OBLIGATIONS WITH REGARD TO THE CONVERTIBLE NOTE AND LAURUS WARRANT, WE MAY INCUR SUBSTANTIAL MONETARY PENALTIES.

The agreements we entered into in connection with our issuance of the Convertible Note and the Laurus Warrant require us to, among other things, register for resale the shares of common stock issued or issuable under the note and the accompanying warrant and maintain the effectiveness of the registration statement for an extended period of time. We are subject to liquidated damage assessment of 2% of the outstanding principal amount of the note for each thirty (30) days of non-compliance thereafter, subject to pro ration for partial months. If we are unable to obtain and maintain effectiveness of the required registration statement, then we may be required to pay additional liquidated damages, to the extent that any amounts are drawn under the Convertible Note, which could adversely affect our business, operating results, financial condition, and ability to service our other indebtedness by negatively impacting our cash flows.

OUR LIMITED OPERATING HISTORY AND LACK OF EXPERIENCE IN OUR NEW OR PROPOSED LINES OF BUSINESS MAKES IT DIFFICULT TO PREDICT OUR FUTURE SUCCESS.

We launched our first microsatellite, CHIPSat, in January 2003 and are developing applications for our other technologies and products. We intend to provide microsatellites to early adopters, primarily the U.S. military (e.g., the Missile Defense Agency), and hybrid rocket motors to government and commercial customers (e.g., the Air Force Research Laboratory and Scaled Composites). As a result, we have limited or no operating histories in each of these new or proposed lines of business. Therefore, our historical financial information is of limited value in projecting our future success in these markets.

OUR PRODUCTS AND SERVICES ARE TECHNOLOGICALLY ADVANCED AND MAY NOT FUNCTION UNDER CERTAIN CONDITIONS.

Most of our products are technologically advanced and sometimes novel systems that must function under demanding operating conditions. Even though we believe that we employ sophisticated design, manufacturing, and testing practices, there can be no assurance that our products will be successfully launched or operated or that they will be developed or will perform as intended. Like most organizations that have launched satellite programs, we will likely experience some product and service failures, schedule delays, and other problems in connection with our products in the future. Our products and services are and will continue to be subject to significant technological change and innovation. Our success will generally depend on our ability to penetrate and retain markets for our existing products and services and to continue to conceive, design, manufacture and market new products and services on a cost-effective and timely basis. We anticipate that we will incur significant expenses in the design and initial manufacture and marketing of new products and services. There can be no assurance that we will be able to achieve the technological advances necessary to remain competitive and profitable, that new products and services will be developed and manufactured on schedule and on a cost-effective basis, that anticipated markets will exist or develop for new products or services, or that our existing products and services will not become

technologically obsolete.

OUR FAILURE TO LAUNCH COULD CAUSE SERIOUS ADVERSE AFFECTS.

Although our current $43 million contract to provide up to six microsatellites to the Missile Defense Agency is a cost-plus agreement, which shifts the risk of failure to the buyer, a launch failure could adversely affect our cash flow in other instances, since a large portion of customer payments may sometimes be contingent upon a successful launch. Microsatellite launches are subject to significant risks, including causing disabling damage to or loss of a microsatellite. Delays in the launch could also adversely affect our revenues as the customer may have timing requirements for milestone payments or we may have guarantee requirements. Delays could be caused by a number of factors, including designing, constructing, integrating, or testing the micro satellite, microsatellite components, or related ground systems; delays in receiving the license necessary to operate the microsatellite systems; delays in obtaining the customer's payload; delays related to the launch vehicle; weather; and other events beyond our control. Delays and the perception of potential delay could negatively affect our marketing efforts. There is no assurance that we will be able to launch microsatellites on a timely basis and any delays in the launch could have a material adverse effect on our financial position.

OUR EXPANSION INTO OTHER NEW LINES OF BUSINESS MAY DIVERT MANAGEMENT'S ATTENTION FROM OUR EXISTING OPERATIONS AND PROVE TO BE TOO COSTLY.

We will migrate our technology from projects into products for microsatellites and hybrid rocket motors over the next several years. In the meantime, we are investigating other applications of our technology and other markets for our technologies and prospective products. Our expansion into new lines of business may be difficult for us to manage because they may involve different disciplines and require different expertise than our core businesses. Consequently, this expansion may detract management's time and attention away from our core business, and we may need to incur significant expenses in order to develop the expertise and reputation we desire, which could prevent us from generating revenues from these lines of business in amounts sufficient to justify the expenses we incur in operating them.

OUR SUCCESS DEPENDS ON OUR ABILITY TO RETAIN OUR KEY PERSONNEL.

Our success is dependent upon the efforts of certain key members of our management and engineering team, including our chief executive officer, James W. Benson, our chief financial officer, Richard B. Slansky, and our vice president of engineering, Randall K. Simpson. Each of these individuals has substantial prior business experience and we have added other experienced key personnel to our staff. The loss of any of these persons could have a material adverse effect on us if suitable replacements are not found. Our future success is likely to depend substantially on our continued ability to attract and retain highly qualified personnel. The competition for such personnel is intense, and our inability to attract and retain such personnel could have a material adverse effect on us. We do not have current key man life insurance on any of our key personnel.

THE U.S. FEDERAL GOVERNMENT MAY INCREASE REGULATION, WHICH COULD CAUSE OUR BUSINESS TO HAVE SERIOUS ADVERSE EFFECTS.

Our business activities are regulated by various agencies and departments of the U.S. federal government and, in certain circumstances, the governments of other countries. Several government agencies, including NASA and the U.S. Air Force, maintain Export Control Offices to ensure that any disclosure of scientific and technical information complies with the Export Administration

Regulations and the International Traffic in Arms Regulations ("ITAR"). Exports of our products, services and technical information require either Technical Assistance Agreements or licenses from the U.S. Department of State depending on the level of technology being transferred. This includes recently published regulations restricting the ability of U.S. based companies to complete offshore launches, or to export certain satellite components and technical data to any country outside the United States. The export of information with respect to ground-based sensors, detectors, high-speed computers, and national security and missile technology items are controlled by the Department of Commerce. The government is very strict with respect to compliance and has served notice that failure to comply with the ITAR and/or the Commerce Department regulations may subject guilty parties to fines of up to US$1 million and/or up to 10 years imprisonment per violation. Failure to comply with any of the above mentioned regulations could have serious adverse effects as dictated by the rules associated with compliance to the ITAR regulations. Our conservative position is to consider any material beyond standard marketing material to be regulated by ITAR regulations.

In addition to the standard local, state and national government regulations that all businesses must adhere to, the space industry has specific regulations. Command and telemetry frequency assignments for space missions are regulated internationally by the International Telecommunications Union ("ITU"). In the United States, the Federal Communications Commission ("FCC") and the National Telecommunications Information Agency ("NTIA") regulate command and telemetry frequency assignments. All launch vehicles that are launched from a launch site in the United States must pass certain launch range safety regulations that are administered by the U.S. Air Force. In addition, all commercial space launches that we would perform require a license from the Department of Transportation. Satellites that are launched must obtain approvals for command and frequency assignments. For international approvals, the FCC and NTIA obtain these approvals from the ITU. These regulations have been in place for a number of years to cover the large number of non-government commercial space missions that have been launched and put into orbit in the last 15 to 20 years. Any commercial deep space mission that we would perform would be subject to these regulations. At the present time, we are not aware of any additional or unique government regulations related to commercial space missions.

We are required to obtain permits, licenses, and other authorizations under federal, state, local and foreign statutes, laws or regulations or other governmental restrictions relating to the environment or to emissions, discharges or releases of pollutants, contaminants, petroleum or petroleum products, chemicals or industrial, toxic or hazardous substances or wastes into the environment including, without limitation, ambient air, surface water, ground water, or land, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of pollutants, contaminants, petroleum or petroleum products, chemicals or industrial, toxic or hazardous substances or wastes or the clean-up or other remediation thereof. At the present time, we do not have a requirement to obtain any special environmental licenses or permits.

Our failure to comply with any of the above-mentioned regulations could have serious adverse effects.

OUR STOCK PRICE HAS BEEN AND MAY CONTINUE TO BE VOLATILE, WHICH COULD RESULT IN SUBSTANTIAL LOSSES FOR INVESTORS PURCHASING SHARES OF OUR COMMON STOCK.

The market prices of securities of technology-based companies like ours are highly volatile. The market price of our common stock has fluctuated

significantly in the past. In fact, during the 52-week period ended June 11, 2004, the high and low closing price of a share of our common stock was $2.05 and $0.51, respectively. Our market price may continue to exhibit significant fluctuations in response to a variety of factors, many of which are beyond our control. These factors include, among others, deviations in our results of operations from estimates, changes in estimates of our financial performance, changes in market valuations of similar companies and stock market price and volume fluctuations generally. Additionally, until the full effects of our cost reduction efforts become clear, including whether those cuts have a long-term negative impact on revenues, it is likely that our quarter-to-quarter performance will be unpredictable and our stock price particularly volatile.

OUR NET OPERATING LOSS CARRYFORWARDS MAY BE SUBJECT TO AN ANNUAL LIMITATION ON THEIR UTILIZATION, WHICH MAY INCREASE OUR TAXES AND DECREASE AFTER-TAX INCOME AND CASH FLOWS.

Deferred income taxes are provided for temporary differences in recognizing certain income and expense items for financial and tax reporting purposes. The deferred tax asset of $2,360,000 and $2,190,000 as of March 31, 2004 and December 31, 2003, respectively, consisted primarily of the income tax benefits from net operating loss and capital loss carryforwards, amortization of goodwill and research and development credits. A valuation allowance has been recorded to fully offset the deferred tax asset as it is more likely than not that the assets will not be utilized. The valuation allowance increased approximately $170,000 in 2004 from $2,190,000 at December 31, 2003 to $2,360,000 at March 31, 2004.

At December 31, 2003 and March 31, 2004, the Company has federal and state tax net operating loss and capital loss carryforwards of approximately $4,673,000 and $1,847,000, respectively. The federal and state tax loss carryforwards will expire in 2023 and 2013, respectively, unless previously utilized. The State of California suspended the utilization of net operating loss for 2002 and 2003.

THE CONCENTRATION OF OWNERSHIP OF OUR COMMON STOCK GIVES A FEW INDIVIDUALS SIGNIFICANT CONTROL OVER IMPORTANT POLICY DECISIONS AND COULD DELAY OR PREVENT CHANGES IN CONTROL.

As of June 11, 2004, our executive officers and directors and their family members together beneficially owned approximately 73% of the issued and outstanding shares of our common stock. As a result, these persons could have the ability to exert significant influential control over matters that could include the election of directors, changes in the size and composition of the board of directors, and mergers and other business combinations involving us. In addition, through control of the board of directors and voting power, they may be able to control certain decisions, including decisions regarding the qualification and appointment of officers, dividend policy, access to capital (including borrowing from third-party lenders and the issuance of additional equity securities), and the acquisition or disposition of our assets. In addition, the concentration of voting power in the hands of those individuals could have the effect of delaying or preventing a change in control of our company, even if the change in control would benefit our stockholders. A perception in the investment community of an anti-takeover environment at our company could cause investors to value our stock lower than in the absence of such a perception.

OUR ABILITY TO PROTECT OUR INTELLECTUAL PROPERTY IS ESSENTIAL TO THE GROWTH AND DEVELOPMENT OF OUR PRODUCTS AND SERVICES.

We rely, in part, on patents, trade secrets and know-how to develop and

maintain our competitive position and technological advantage. We have a program and plan to protect our intellectual property through a combination of license agreements, patents, trademarks, service marks, copyrights, trade secrets and other methods of restricting disclosure and transferring title. There is no guarantee that such applications will be granted. We have and intend to continue entering into confidentiality agreements with our employees, consultants and vendors; entering into license agreements with third parties; and generally seeking to control access to and distribution of our intellectual property.

OUR ABILITY TO SOURCE AND OBTAIN COMPONENTS AND RAW MATERIALS COULD AFFECT OUR ABILITY TO SATISFY CUSTOMER ORDERS OR CONTRACTS.

We purchase a significant percentage of our components, including structural assemblies, electronic equipment, and computer chips, from third parties. We also occasionally obtain from the U.S. Government parts and equipment that are used in our projects or in the provision of our services. To date, we have not experienced material difficulty in obtaining product components or necessary parts and equipment. While we believe that alternative sources of supply would be available, we may experience increased costs and possible delays in securing alternative sources of supply. We cannot guarantee that alternative sources of supply would be available if and when required by us.

OUR ABILITY TO OBTAIN ONLY LIMITED INSURANCE MAY NOT COVER ALL RISKS.

We may find it difficult to insure certain risks involved in our operations. Insurance market conditions or factors outside of our control at the time the insurance is purchased could cause premiums to be significantly higher than current estimates. Additionally, the U.S. Department of State has published regulations, which could significantly affect the ability of brokers and underwriters to place insurance for certain launches. These factors could cause other terms to be significantly less favorable than those currently available, may result in limits on amounts of coverage that we can obtain, or may prevent us from obtaining insurance at all. Furthermore, there is no assurance that proceeds from insurance that we are able to purchase will be sufficient to cover losses.

OUR GROWTH MAY NOT BE MANAGEABLE.

Even if we are successful in obtaining new business, failure to manage the growth could adversely affect our condition. We may experience extended periods of very rapid growth. This growth could place a significant strain on our management, operating, financial and other resources. Our future performance will depend in part on our ability to manage growth effectively. We must develop management information systems, including operating, financial, and accounting systems and expand, train, and manage employees to keep pace with growth. Our inability to manage growth effectively could negatively affect results of operations and the ability to meet obligations as they come due.

OUR BUSINESS COULD BE ADVERSELY AFFECTED BY TERRORIST ATTACKS.

Our business partially depends on activities regulated by various agencies and departments of the U.S. government and other companies that rely on the government. In the recent past, in response to terrorists' activities and threats aimed at the United States, transportation, mail, financial, and other services have been slowed or stopped altogether. Further delays or stoppages in transportation, mail, financial, or other services could have a material adverse effect on our business, results of operations, and financial condition. Furthermore, we may experience a small increase in operating costs, such as

costs for transportation, insurance, and security as a result of the activities and potential activities. The U.S. economy in general has been adversely affected by the terrorist activities and potential activities, and any economic downturn could adversely impact our results of operations, impair our ability to raise capital, or otherwise adversely affect our ability to grow our business. Conversely, because of the nature of our products and services, there may be opportunities for us to offer solutions to the government that may address some of the problems that the country faces at this time.

OUR INVESTORS MAY NOT RECEIVE DIVIDENDS.

We have not paid dividends since our inception and do not anticipate issuing them in the foreseeable future. There can be no guarantee or assurance that dividends will ever be paid. In fact, our goal is to reinvest earnings in an effort to complete development of our technologies and products, and to increase sales and long-term profitability and value. In addition, the revolving credit facility with Laurus or other bank lines of credit, which we may establish in the future or other credit or borrowing arrangements may significantly impact our ability to pay dividends to our shareholders.

OUR SHAREHOLDERS MAY EXPERIENCE DILUTION IF OUR OUTSTANDING WARRANTS AND OPTIONS ARE EXERCISED.

We are obligated to issue 1,512,746 shares of our common stock if all of our outstanding warrants, outside of the warrants in this offering, are exercised. In addition, as of June 11, 2004, we have outstanding stock options to purchase an aggregate of 6,623,772 shares of our common stock, including 2,003,334 unvested options issued to our Chief Executive Officer. The total number of shares, which could be issued upon the exercise of currently vested warrants and options (4,354,028 shares) represents approximately 23% of our issued and outstanding shares of common stock as of June 11, 2004. Shares of common stock issued as a result of the exercise of stock options will have a dilutive effect, which could be substantial, on the currently and then outstanding shares of common stock.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. We intend that those forward-looking statements be subject to the safe harbors created by those sections. These forward-looking statements generally include the plans and objectives of management for future operations, including plans and objectives relating to our future economic performance, and can generally be identified by the use of the words "believe," "intend," "plan," "expect," "forecast," "project," "may," "should," "could," "seek," "pro forma," "estimates," "continues," "anticipate" and similar words. The forward-looking statements and associated risks may include, relate to, or be qualified by other important factors, including, without limitation:

- our ability to be profitable and obtain additional working capital, if required;
- our ability to successfully implement our future business plans;
- our ability to attract strategic partners, alliances and advertisers;
- our ability to hire and retain qualified personnel;
- the risks of uncertainty of trademark protection;
- risks associated with existing and future governmental regulation to which we are subject; and,
- uncertainties relating to economic conditions in the markets in which we

currently operate and in which we intend to operate in the future.

These forward-looking statements necessarily depend upon assumptions and estimates that may prove to be incorrect. Although we believe that the assumptions and estimates reflected in the forward-looking statements are reasonable, we cannot guarantee that we will achieve our plans, intentions or expectations. The forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results to differ in significant ways from any future results expressed or implied by the forward-looking statements. We do not undertake to update, revise or correct any forward-looking statements.

Any of the factors described above or in the "Risk Factors" section above could cause our financial results, including our net income (loss) or growth in net income (loss) to differ materially from prior results, which in turn could, among other things, cause the price of our common stock to fluctuate substantially.

SELLING SECURITY HOLDERS

Laurus may sell, from time to time, under this prospectus, 588,235 shares of our common stock, representing 100% of the shares that may become issuable upon conversion of the principal of and interest on the Convertible Note at the fixed conversion price of $0.85 per share. Laurus may also exercise and sell, from time to time, under this prospectus, warrants on 50,000 shares of our common stock. Laurus may also convert principal and interest on the Convertible Note into our common stock only to the extent that there are amounts outstanding under the revolving credit facility described under "Description of Business - The Laurus Master Fund Ltd. Revolving Credit Facility" below and only if we have not repaid the outstanding amounts before Laurus exercises its conversion rights.

The following table sets forth, to our knowledge, certain information about Laurus as of June 11, 2004. Beneficial ownership is determined in accordance with the rules of the Commission, and includes voting or investment power with respect to the securities. In computing the number of shares beneficially owned by a holder and the percentage ownership of that holder, shares of common stock subject to options or warrants or underlying convertible notes held by that holder that are currently exercisable or convertible or are exercisable or convertible within 60 days after the date of the table are deemed outstanding. To our knowledge, Laurus has sole voting and investment power with respect to all shares of common stock shown as beneficially owned by it, except that Laurus Capital Management, LLC, a Delaware limited liability company, may be deemed a control person of the shares owned by Laurus. David Grin and Eugene Grin are the principals of Laurus Capital Management, LLC. The address for Messrs. David Grin and Eugene Grin is 152 West 57th Street, New York, NY 10019.

Percentage of beneficial ownership is based on presumed ownership of 19,478,307 shares of common stock outstanding as of June 11, 2004. Actual ownership of the shares is subject to conversion of the Convertible Note and exercise of the Warrant.

	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING	SHARES OF COMMON STOCK BEING	SHARES OF COMM STOCK BENEFICIA OWNED AFTE OFFERING (1)

SELLING SECURITY HOLDER.	NUMBER	PERCENTAGE	REGISTERED	NUMBER	PERCENTAG
LAURUS MASTER FUND, LTD.	250,000(2)	1.37%	638,235	250,000	1.28

(1) The amount assumes the sale of all shares being offered under this prospectus.

(2) The number and percentage of shares beneficially owned is determined in accordance with Rule 13d-3 of the Securities Exchange Act of 1934, and the information is not necessarily indicative of beneficial ownership for any other purpose. Under such rule, beneficial ownership includes any shares as to which the selling security holder has sole or shared voting power or investment power and also any shares, which the selling stockholder has the right to acquire within 60 days. The actual number of shares of common stock issuable upon the conversion or payment of the Convertible Note is subject to the amount drawn under the note. Furthermore, the selling stockholder has contractually agreed, absent an event of default under the revolving credit facility, to restrict its ability to convert the convertible note or exercise its warrants and receive shares of our common stock if the number of shares of common stock held by it and its affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of common stock. Laurus may void this restriction upon seventy-five days prior written notice to us.

All other selling security holders named in this prospectus are offering up to 614,853 shares of common stock through this prospectus, subject to exercise of warrants issued to them in a convertible debt offering following the conversion of interest on and/or principal of the convertible note held by the selling security holders. These security holders consist of our CEO and CFO, Mr. Schaffer, who currently sits on our Board of Directors, and Emery Skarupa, our former Vice President of Operations. Each of these selling shareholders, aside from Mr. Skarupa, is subject to insider trading restrictions set forth in the Securities Exchange Act of 1934, the SEC rules and regulations promulgated thereunder and our internal insider trading policy.

The following table sets forth, as of the date of this prospectus, the name of each selling security holder, the number of selling security holders (excluding Laurus), the aggregate number of shares owned by each selling security holder, and the number of shares each selling security holder will own after the completion of the offering made pursuant to this prospectus. For purposes of establishing ownership and shares offered, we have assumed the exercise of all of the outstanding Warrants under this offering:

Name Of Selling Stockholder	Shares Owned Prior To This Offering	Total Number Of Shares To Be Offered For Selling Shareholders Account	Total Shares to Be Owned Upon Completion of This Offering	Percentage of Shares Owned Upon Completion of This Offering
James W. Benson. .	(1) 9,241,707	486,647	8,755,060	44.95%
Stuart Schaffer. .	(2) 128,206	64,103	64,103	0.33%
Emery Skarupa. . .	51,282	25,641	25,641	0.13%
Richard B. Slansky	(3) 79,357	38,462	40,895	0.21%

(1) Mr. Benson is our Founding Chairman and Chief Executive Officer. Mr. Benson owns 8,257,647 shares held directly by Mr. Benson and his wife, Susan Benson, (including 486,647 shares as part of the Company's convertible debt repayment when he converted $187,500 of his debt into shares in 2003); 497,413 shares transferred from SD Holdings, LLC to Space Development Institute, a 501(c)(3) corporation; plus vested options on 506,666 shares; and, warrants that are being registered hereunder on 486,647 shares (Mr. Benson forgave half of his warrants on 973,294 shares as part of the convertible debt repayment). In addition, Mr. Benson has unvested options on 2,003,334 shares. In 2003, 8,245,000 shares were transferred from SD Holdings, LLC, an entity previously controlled by Mr. Benson, directly to Mr. Benson and his children. Mr. Benson's children now hold 1,312,000 shares. Mr. Benson disclaims ownership of shares held by his children.

(2) Mr. Schaffer is a current member of our Board of Directors, is our former Vice President of Marketing and Product Development and a loyal stockholder. In addition to the Warrants, Mr. Schaffer holds options to purchase an additional 90,000 shares of our common stock.

(3) Mr. Slansky is our Chief Financial Officer and Corporate Secretary. In addition to the Warrants, Mr. Slansky holds 40,895 shares of which 38,462 shares he purchased for cash in a private transaction with Mr. Skarupa, our former Vice President of Operations; 38,462 warrants which were also purchased from Mr. Skarupa and are being registered hereunder; and, vested options on 129,000 shares. Mr. Slansky also holds 621,000 unvested options.

(4) For purposes of calculating percentage of ownership, we assumed the exercise of all of the, the Convertible Note and the Laurus Warrant. We did not assume exercise of all other outstanding derivative securities. Ownership is based on the total outstanding shares of common stock on June 11, 2004 plus shares issuable upon exercise of the Warrants, the Convertible Note and the Laurus Warrant, or 19,478,307 shares.

All costs, expenses and fees incurred in connection with the registration of the selling security holders' shares will be borne by us. All brokerage commissions, if any, attributable to the sale of shares by selling security holders will be borne by selling security holders.

PAGE 19

PLAN OF DISTRIBUTION

The selling security holders, and any of their donees, pledgees, assignees and other successors-in-interest, may, from time to time, sell any or all of their shares of common stock being offered under this prospectus on any stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales, which may include block transactions, may be at fixed or negotiated prices. The selling security holders may use any one or more of the following methods when selling shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resales by the broker-dealer for its own account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- broker-dealers may agree with the selling security holder to sell a

specified number of shares at a stipulated price per share;
a combination of any of these methods of sale; or
any other method permitted by applicable law, except (a) that Laurus has agreed that it has not engaged and will not engage or cause, advise, ask or assist any person or entity, directly or indirectly, or engage, in short sales or our common stock, which are contracts for the sale of shares of stock that the seller does not own, or certificates which are not within the seller's control, so as to be available for delivery at the time when, under applicable rules, delivery must be made, and (b) that selling shareholders who also qualify as insiders of the Company are restricted from engaging in short sales and other trading transactions specified in our internal insider trading policy.

The sale price to the public may be:

the market price prevailing at the time of sale;
a price related to the prevailing market price;
at negotiated prices; or
a price the selling security holder determines from time to time.

Laurus has agreed, pursuant to the Securities Purchase Agreement, that it has not engaged and will not engage or cause, advise, ask or assist any person or entity, directly or indirectly, to engage, in short sales of our common stock.

Broker-dealers engaged by the selling security holders may arrange for other broker-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the selling security holder (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated. The selling security holder does not expect these commissions and discounts to exceed what is customary in the types of transactions involved.

PAGE 20

The selling security holders and any broker-dealers or agents that are involved in selling the shares may be deemed to be "underwriters" within the meaning of the Securities Act in connection with these sales. Commissions received by these broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Any broker-dealers or agents that are not deemed to be underwriters may not sell shares offered under this prospectus unless and until we set forth the names of the underwriters and the material details of their underwriting arrangements in a supplement to this prospectus or, if required, in a replacement prospectus included in a post-effective amendment to the registration statement of which this prospectus is a part.

In the event sales are made to broker-dealers as principals, we would be required to file a post-effective amendment to the registration statement of which the prospectus forms a part. In such post-effective amendment, we would be required to disclose the names of any participating broker-dealers and the compensation arrangements relating to such sales. In addition, if any shares of common stock or warrants offered for sale pursuant to this prospectus are transferred, subsequent holders could not use this prospectus until a post-effective amendment is filed, naming such holder.

The selling security holders, alternatively, may sell all or any part of the shares offered under this prospectus through an underwriter. To our knowledge, the selling security holders have not entered into any agreement with a prospective underwriter, and we cannot assure you as to whether any such agreement will be entered into. If any selling security holder informs us that

it has entered into such an agreement or agreements, any material details will be set forth in a supplement to this prospectus or, if required, in a replacement prospectus included in a post-effective amendment to the registration statement of which this prospectus is a part.

This prospectus does not cover the sale or other transfer of the Convertible Note, the Laurus Warrant or the Warrants. If the selling security holders transfer any such securities prior to conversion or exercise, the transferee of those derivative securities may not sell the shares of common stock issuable upon conversion or exercise of those derivative securities under the terms of this prospectus unless we amend or supplement this prospectus to cover such sales.

For the period a holder holds the Convertible Note and/or the Laurus Warrant, with respect to Laurus, or the Warrants, with respect to all other selling security holders, the holder has the opportunity to profit from a rise in the market price of our common stock. The terms on which we could obtain additional capital during the period in which those derivative securities remain outstanding may be adversely affected. The holders of the derivative securities are most likely to voluntarily convert or exercise those derivative securities when the conversion price or exercise price is less than the market price for our common stock. However, we cannot assure you as to whether any of those derivative securities will be converted or exercised.

We have agreed with Laurus to keep the registration statement of which this prospectus constitutes a part effective until the earlier of three years or the termination of the Securities Purchase Agreement, as amended.

PAGE 21

USE OF PROCEEDS

We will not receive any proceeds from the sale of the shares of our common stock offered by Laurus and other selling security holders under this prospectus. Upon exercise of the Laurus Warrant and the Warrants, we will receive proceeds from the Warrant holder; however, upon selling the common stock underlying the Secured Convertible Note and/or the Laurus Warrant and the Warrants, the selling security holder will receive all proceeds directly.

DESCRIPTION OF BUSINESS

FORWARD LOOKING STATEMENTS

The following discussion should be read in conjunction with our 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 the disclosures made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our General Registration Statement on Form 10SB12G/A filed January 28, 2000 and in our other periodic reports (e.g., Form 10-KSB, Form 10-QSB and Form 8-K).

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 prospectus 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 us; 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; fluctuations in economic conditions; 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 in Afghanistan and Iraq; 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.

GENERAL

SpaceDev, Inc. (the "Company," "SpaceDev," "we," "us" or "our") is engaged in the conception, design, development, manufacture, integration and operations of space technology subsystems, systems, products and services. We are currently focused on the commercial and military development of low-cost microsatellites, nanosatellites and related subsystems, hybrid rocket propulsion for space and launch vehicles, as well as the associated engineering technical services to government, aerospace and other commercial enterprises. Our products and solutions are sold directly to these customers and include sophisticated micro- and nanosatellites, hybrid rocket-based launch vehicles, orbital Maneuvering and orbital Transfer Vehicles as well as safe sub-orbital and orbital hybrid rocket-based propulsion systems. 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.

Our approach is to provide smaller spacecraft - generally 250 kg (550 pounds) mass and less - and cleaner, safer hybrid propulsion systems to commercial, international and government customers. We are developing smaller spacecraft and miniaturized subsystems using proven, lower cost, high-quality off-the-shelf components. Our space products are modular and reproducible, which allows us to create affordable space solutions for our customers. By utilizing our innovative technology and experience, and space-qualifying commercial industry-standard hardware, software and interfaces, we provide increased reliability with reduced costs and risks.

We have been awarded, have successfully concluded or are successfully concluding contracts from such esteemed government, university and commercial customers as the Air Force Research Laboratory, Boeing, the California Space Authority, the Defense Advanced Research Projects Agency, National Aeronautics and Space Administration's Jet Propulsion Laboratory, Lockheed Martin, the Lunar Enterprise Corporation, Malin Space Science Systems, the Missile Defense Agency

(formerly the Ballistic Missile Defense Organization), the National Reconnaissance Office, Scaled Composites and the University of California at Berkeley via NASA.

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."

In February 1998, we acquired Integrated Space Systems, in San Diego. Integrated Space Systems was fully integrated into SpaceDev. Most of the Integrated Space Systems employees were former commercial Atlas launch vehicle engineers and managers who worked for General Dynamics in San Diego. As SpaceDev employees, they primarily develop systems and products based on hybrid rocket motor technology and launch vehicle systems.

In August 1998, we acquired a license to the patents and intellectual property produced by American Rocket Company ("AMROC"). The acquisition provided us access to a large cache of hybrid rocket documents, designs and test results. AMROC specialized in the design, development and testing of hybrid rocket technology (solid fuel plus liquid oxidizer) for small sounding rockets and launch vehicles.

In late 1998, we bid and won a government-sponsored research and development contract, which was directly related to our strategic commercial space interests. We competed with seven other industry teams and we were one of five firms selected by Jet Propulsion Laboratory to perform a mission and spacecraft feasibility assessment study for the proposed 200-kg Mars MicroMissions. The final report was delivered to Jet Propulsion Laboratory in March 1999 and, as a result, we now offer lunar and Mars commercial deep-space missions based on this and subsequent innovative space system designs.

In mid-1999, we won an R&D contract from the National Reconnaissance Office to study small hybrid-based "micro" kick-motors for small-satellite orbital transfer applications. During the contract, we successfully developed three Secondary Payload Orbital Transfer Vehicle ("SPOTV") design concepts. We subsequently created a prototype, which led to the development of our capability to apply the SPOTV concept to our subsequent Maneuvering and orbit Transfer Vehicles development programs.

In November 1999, we won a $4.9 million mission contract by the Space Sciences Laboratory ("SSL") at the University of California at Berkeley. We were competitively selected 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. Due to additional NASA and customer reviews, additional work and schedule extensions, the CHIPSat contract award was increased by $600,000 on June 15, 2001 and again by $1.2 million on November 28, 2001, bringing the total contract value for design and build to approximately $6.8 million. An extension of the original contract based on our successful launch and orbit status in the amount of approximately $400,000 was

awarded to us for one year of satellite operations. CHIPSat launched as a secondary payload on a Delta-II rocket on January 12, 2003. The satellite, the world's first orbiting Internet node, 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 more than a year. The CHIPSat program generated approximately $2.1 million, $3.2 million, $1.7 million and $0.4 million of revenue in 2000, 2001, 2002 and 2003, respectively.

On March 22, 2000, the California Spaceport Authority and the California Space and Technology Alliance ("CSTA") awarded us a grant of approximately $100,000 to be used for test firing our hybrid rocket motors. California's Western Commercial Space Center also awarded us approximately $200,000 to help build and equip its satellite and space vehicle manufacturing facilities. These capabilities are being used to expand our current project and technology base.

In July 2000, the National Reconnaissance Office granted us two separate follow-on competitive awards of approximately $400,000 each for further hybrid rocket engine design, test, evaluation, and development. Our work for the National Reconnaissance Office has helped fund two innovative hybrid rocket motor products:

- a family of small versatile orbital Maneuver and orbit Transfer Vehicles using clean, safe hybrid rocket propulsion technology; and,
- a protoflight hybrid propulsion module for a 50-kg class microsatellite.

Both of those contracts were successfully completed.

In September 2001, Scaled Composites awarded us a contract for a proprietary hybrid propulsion development program for Scaled's "SpaceShipOne," valued in excess of $1 million. As a part of that program, we competed with another party to design a space propulsion system. The entire contract, awarded upon the submitted designs, was valued at approximately $2.2 million. The contract was indicative of an increased demand for our hybrid motor technology and expertise in the space industry. Work on this project generated approximately $1.2 million and $397,000 of revenue in 2002 and 2003, respectively. In September of 2003, SpaceDev was selected by Scaled Composites as the sole supplier of hybrid propulsions systems, and was awarded the follow-on SpaceShipOne propulsion contract. We generated approximately $115,000 of revenue in 2003 from this new contract and related engineering change orders. On December 17, 2003, which corresponded with the 100th anniversary of the Wright Brothers flight, our hybrid propulsion system, which we believe is the world's largest of its kind, aboard SpaceShipOne, successfully powered a pilot toward space on its historic first powered supersonic flight. After being released by the White Knight, a carrier aircraft, the SpaceShipOne Test Pilot flew the ship to a stable 0.55 mach gliding flight condition, started a pull-up and fired our hybrid rocket motor. Nine seconds later, SpaceShipOne broke the sound barrier and continued its steep powered ascent. The climb was very aggressive, accelerating forward at more than 3-g while pulling upward at more than 2.5-g. At motor shutdown, 15 seconds after ignition, SpaceShipOne was climbing at a 60-degree angle and flying near 1.2 Mach (930 mph). The test pilot then continued the maneuver to a vertical climb, achieving zero speed at an altitude of 68,000 feet. This is important because we are showing that the private sector can perform human space flight in a rapid, safe and inexpensive manner. In addition, our rocket motor technology successfully propelled SpaceShipOne on its second historic manned powered flight on April 8, 2004, achieving a speed of 1.6 Mach and altitude of 105,000 feet, in Scaled Composites' goal to win the $10 million X-Prize for stimulating the development of a private sector human space flight industry. And, on May 13, 2004, our hybrid rocket motor technology successfully propelled SpaceShipOne on its third

manned flight accelerating to 2.5 Mach and setting an altitude record of 211,400 feet. These historic flights are the first human flights ever powered by hybrid rocket technology, and we provided the critical hybrid motor components and technology to make it happen.

On April 4, 2002, SpaceDev, Inc., an Oklahoma corporation, was formed for the purpose of investigating and developing commercial space products in the state of Oklahoma. We currently have no plans to develop this business in Oklahoma.

On April 30, 2002, we were awarded Phase I of a contract to develop a Shuttle-compatible propulsion module for AFRL. We received an award for Phase II of the contract on March 28, 2003. We are using the project to further expand our Maneuvering and orbital Transfer Vehicles technology and product line to satisfy government space transportation requirements. The first two phases of the contract have an estimated value of approximately $2.5 million, of which $100,000 was awarded for Phase I. Phase II was expanded on May 3, 2004 with the exercise of an option, which was at the discretion of AFRL, for an additional $1 million.

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 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.

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. 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.

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 $481,000 of revenue realized in the year

ending December 31, 2003 and approximately $319,000 of revenue realized in the first quarter of 2004. The total value of our microsatellite studies for MDA was over $1 million in 2003.

On July 24, 2003, we were awarded a contract by Lunar Enterprise of California ("LEC") for a first phase project to begin developing a conceptual mission and spacecraft design for a lunar lander program. The unmanned mission will be designed to put a small dish antenna near the south pole of the Moon. From that location it will be in near-constant sunlight for solar power generation, and should be able to perform multi-wavelength astronomy while communicating with ground stations on Earth. The contract value was $100,000 and was completed by November 2003. We believe that there is a possibility for a follow-on phase to further analyze launch opportunities, spacecraft design, trajectory possibilities, potential landing areas, available technologies for a small radio astronomy system, and communications and data handling requirements. Although this project is currently unfunded, if the project were to proceed past the analysis stage, the total mission cost could exceed $50-$75 million. Again, we can give no assurance that the contract will be awarded to us. Revenues for the year ending December 31, 2003 were approximately $70,000.

PAGE 26

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 & technical personnel in continued support of the SpaceShipOne program. The contract calls 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 are to 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 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.

On March 31, 2004, we were awarded a $43,362,271, five-year, cost-plus-fixed fee indefinite delivery/indefinite quantity contract to conduct a microsatellite 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 February 2009. Government contract funds will not expire at the end of the current government fiscal year. The microsatellite distributed sensing experiment is intended to design and build up to six responsive, affordable, high performance microsatellites to support national missile defense. The milestone-based, multiyear, multiphase contract has an effective start date of March 1, 2004. 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 October 1, 2004 and run through 2005.

BUSINESS STRATEGY

Our strategy is based on the belief that innovative advancements in technology and the application of standard business processes and practices will make access to space much more practical and affordable. We believe these factors will cause growth in certain areas of space commerce and will create new space markets and increased demand for our proprietary products.

Our business strategy is to:

- Introduce commercial business practices into the space arena, use off-the-shelf technology in innovative ways and standardize hardware and software to reduce costs and to increase reliability and profits;

- Start with small, practical and profitable projects, and leverage credibility and profits into larger and ever more bold initiatives - utilizing partnerships where appropriate;

- Bid, win and leverage government programs to fund our research and development ("R&D") and product development efforts;

- Integrate our smaller, low cost commercial spacecraft and hybrid space transportation systems to provide one-stop turnkey payload and/or data delivery services to target customers;

- Apply our low cost space products to new applications and to create new users, new markets and new revenue streams;

- Produce and fly commercial missions, in conjunction with partners and investors, throughout the inner solar system in the commercial beyond earth orbit "space"; and

- Join or establish a team to build a safe, affordable sub-orbital, passenger space plane to help initiate the space tourism business.

We believe that our business model, emphasizing smaller satellites, commercial approaches, technological simplicity, architectural and interface standardization and horizontal integration (i.e., "whole product"), provides the following advantages:

- Enables small-space customers to contract for end-to-end mission solutions, reducing the need for and complexity of finding other contractors for different project tasks;

- Decreases schedule time and lowers total project costs, thereby providing greater value and increases return on investment for us and our customers; and

- Creates barriers to entry by and competition from competitors.

PRODUCTS AND SERVICES; MARKET

We currently have three primary lines of space products and services on which we believe a sound foundation and profitable, cash generating business can be built:

- Our Products - Microsatellites & Nanosatellites, BD-II Spacecraft Bus, Maneuvering and orbital Transfer Vehicle and Hybrid Propulsion and

Launch Vehicle Systems;

- Our Subsystem Products - Miniature Flight Computer, Micro-Space Vehicle Operating System (micro space vehicle operating system), PC-DS (power conditioning and distribution system) and Miniature S-Band Transmitter; and,

- Our Services - Mission Analysis and Design, Spacecraft and Subsystem Design, Microsatellite and Nanosatellite Launches and Mission Control and Operations.

These products and services are being marketed and sold directly into primarily domestic government, university, military and commercial markets. Our business is not seasonal to any significant extent; however, our business follows normal industry trends such as increased demand during bullish economic periods, or slow-downs in demand during periods of recession.

In addition, we are working with partners to create new markets that can generate new space-related service, media, tourism and commercial revenue streams. While we believe that certain space market opportunities are still several years away, we are currently working with industry-leading partners to develop unique enabling technology for the potentially very large sub-orbital manned space plane tourism market; and, creating a new unmanned Beyond Earth Orbit commercial market with spacecraft derived from our NASA Jet Propulsion Laboratory Mars MicroMission and Boeing Lunar Orbiter mission design contracts.

Our Products

Microsatellites & Nanosatellites - We design and build small, light, high-performance, reliable and affordable micro- and nanosatellites. The primary benefit of micro- and nanosatellites is lower cost and weight. Since we can dramatically reduce manufacturing costs and the costs to launch the satellites to earth-orbit and deep space, we can pass those cost savings on to our customers. Small, inexpensive satellites were once the exclusive domain of scientific and amateur groups; however, smaller satellites are now a viable alternative to larger, more expensive ones, as they provide cost-effective solutions to traditional problems. We design and build low cost, high performance space-mission solutions involving microsatellites (generally less than 100 kg) and even smaller satellites (less than 50 kg). Our approach is to provide smaller spacecraft and compatible low cost, safe hybrid propulsion space systems to a growing market of commercial, government and potentially international customers.

BD-II (Boeing Delta-II compatible) spacecraft bus - We have a qualified microsatellite bus available to sell as a standard, fixed-price product to government and commercial customers needing an affordable satellite for small payloads. We began developing this product in 1999, when we were selected as the mission designer, spacecraft bus provider, integrator and mission operator of CHIPSat. CHIPSat was launched at 4:45 PM PST on January 12, 2003 from Vandenberg Air Force Base in California.

Maneuvering and orbital Transfer Vehicle - Our Maneuvering and orbital Transfer Vehicles system is a family of small, affordable, elegantly simple, throttleable, and restartable propulsion and integrated satellite products. Our Maneuvering and orbital Transfer Vehicles can be used as a standard propulsion module to transport a customer's payload to different orbits. The Maneuvering and orbital Transfer Vehicles provide the change in velocity and maneuvering capabilities to support a wide variety of applications for on-orbit maneuvering, proximity operations, rendezvous, inspection, docking, surveillance, protection,

inclination changes and orbital transfers.

Hybrid Rocket Propulsion and Launch Vehicle System - We provide a wide variety of safe, clean, simple, reliable, cost-effective hybrid propulsion systems to safely and inexpensively enable satellites and on-orbit delivery systems to rendezvous and maneuver on-orbit and deliver payloads to sub-orbital altitudes. Hybrid rocket propulsion is a safe and low-cost technology that has tremendous benefits for current and future space missions. Our hybrid rocket propulsion technology features a simple design, is restartable, is throttleable and is easy to transport, handle and store. We acquired some of our expertise in hybrid propulsion technology from AMROC. We are using this technology to develop the responsive, affordable SpaceDev Streaker(TM) small launch vehicle under an Air Force contract.

Our Subsystem Products

Miniature Flight Computer - Our Miniature Flight Computer is a high performance 300 million instructions per second general-purpose space-qualified flight computer for a wide variety of space vehicles. It is cost-effective, has about ten times the performance-to-power ratio of current flight computers and only uses 0.5 to 6 watts of power, depending on its tasks. Our Miniature Flight Computer has successfully passed manufacturing and environmental testing and over 14 months of reliable operations in low earth orbit ("LEO"), and is ready for civil, military and commercial spacecraft and launch vehicle applications.

Micro Space Vehicle Operating System - Our Micro-Space Vehicle Operating System is a small, fast, modular and layered operating system, similar to the operating systems of microcomputers. The modular nature of our Micro-Space Vehicle Operating System and our other space products allow us to design and build affordable space solutions for our customers. We use industry-standard interfaces to increase reliability while reducing cost. Our Micro-Space Vehicle Operating System combines standard protocols like TCP/IP, software components like VxWorks(R) and application software to effect real time command and control, scriptable autonomous vehicle control, scriptable data acquisition and telemetry.

Mission Control and Operations Software ("MC-OS") - Our MC-OS performs satellite command and control and data acquisition. This general purpose software permits direct command, control and data operations from any laptop computer anywhere in the world. The MC-OS satellite command and control is managed via user commands, batched command scripts and timed command scripts. MC-OS components include direct, real-time interactive Telnet communications with the satellite, file transfer protocol ("FTP") for file transfer between the ground station and satellite, a system security module which assigns users a password, command level and logs all user commands to disk, and a status window for monitoring MC-OS status.

Power Conditioning and Distribution System ("PC-DS") - Our PC-DS controls critical failsafe spacecraft functions, including battery charge control, bus voltage regulation, load power switching, current monitoring & limiting for the spacecraft and individual loads, and hardware load-shedding protection for spacecraft contingency management, and allows direct ground control of power switches. Our PC-DS is capable of keeping the spacecraft alive independent of any other spacecraft computers.

Our Miniature S-Band Transmitter and Miniature S-Band Receiver are cost-effective solutions for low cost and low mass spacecraft. The Miniature S-Band Transmitter and the Miniature S-Band Receiver feature lightweight state-of-the-art electronic circuitry designed to meet today's requirements for

power efficient space-based communications hardware. The weight of the transmitter and receiver are 2.5-oz and 32-oz, respectively. These units leverage years of communications design heritage and have been operating on-orbit since the January 12, 2003 launch of CHIPSat, the first mission to be funded through NASA's University Explorer Program and the first and only successful University Explorer mission to date. The Miniature S-Band Transmitter and the Miniature S-Band Receiver designs provide flexibility to meet customer requirements and options. Both units are designed to operate in most present day thermal, launch, and on-station LEO spacecraft environments.

PAGE 30

Our Services

Mission Analysis and Design - We can provide end-to-end mission design and analysis, including the design of the mission and its science, commerce or technology demonstration goals, the design of an appropriate space vehicle (satellite or spacecraft), prototype development, construction and testing of the spacecraft, integration of one or more payloads (instruments, experiments or technologies) into the spacecraft, integration of the spacecraft onto the launch vehicle (rocket), the launch and the mission control and operations during the life of the mission.

Spacecraft and Subsystem Design - We also provide reliable, affordable access to space through innovative solutions currently lacking in the marketplace. Our approach is to provide smaller spacecraft - generally 250 kg mass and less - and compatible hybrid propulsion space systems to commercial, university and government customers. The small spacecraft market is supported by the evolution and enabling of microelectronics, common hardware & software interface standards, and smaller launch vehicles. Reduction of the size and mass of traditional spacecraft electronics has reduced the overall spacecraft size, mass, and volume over the past 10 to 15 years. For example, our Miniature Flight Computer is only 24 cubic inches and provides 300 million instructions per second of processing power versus a competitor's more "traditional" solution that requires about 63 cubic inches and only provides 10 million instructions per second.

Microsatellite & Nanosatellite Launches - To support the growth in customer demand within the small satellite market, we work with launch providers to identify and market affordable launch opportunities and to provide customers with a complete on-orbit data delivery service that combines our spacecraft and hybrid propulsion products. These innovative, low-cost, turnkey launch solutions will allow us to provide one-stop shopping for launch services, spacecraft, payload accommodation, total flight system integration and test and mission operations. The customer only needs to provide the payload, and we are capable to perform all the tasks required for the customer to get to orbit and to begin collecting their data.

Mission Control and Operations - Our mission control and operations center, located in our headquarters building near San Diego, coupled with our mission control and operations package, is uniquely Internet-based and allows for the operation and control of missions from anywhere in the world that has access to the Internet. CHIPSat is the first U.S. mission to use end-to-end satellite operations with TCP/IP and FTP. While this concept has been analyzed and demonstrated by the NASA OMNI team, CHIPSat is the first to implement the concept as the only means of satellite communication. A formation flying cluster or constellation of TCP/IP-based microsatellites, can be designed to communicate directly with each other, as in a wide area network in space. Providing any one satellite/node in this network is in line-of-sight with any ground station at any given time, the entire constellation could always maintain ground station connectivity, thus creating a network on-orbit and on the web, a

direct extension of CHIPSat's elegantly simple TCP/IP mission operations architecture.

COMPONENTS AND RAW MATERIALS

Although we may experience a shortage of certain parts and components related to our products, we have many alternative suppliers and distributors and are not dependent on any individual supplier or distributor. We have not experienced difficulty in our ability to obtain our parts or component materials to date, and do not currently expect this to be an issue in the future; however, we can provide no assurances that alternative sources would be available on terms favorable to us or at the time we would require them.

COMPETITION

We compete for sales of our products and services based on price, performance, technical features, contracting approach, reliability, availability, customization, and, in some situations, geography. Our primary competition for low-cost propulsion systems using clean, safe, commercially available hybrid rocket motor technology comes from Cesaroni Technology Incorporated in Canada and their affiliates. While Lockheed Martin has demonstrated large-scale hybrid rocket capability, and there are a number of smaller enterprises, especially academic-based organizations, in the domestic market currently investigating various aspects of hybrid rocket technology, to-date we have seen limited competitive pressures arising from these organizations.

The primary domestic competition for unmanned earth-orbiting microsatellites, unmanned deep space micro-spacecraft and microsatellite subsystems as well as software systems comes from other small companies such as AeroAstro, Orbital Sciences and Spectrum Astro. The most established international competitors are Surrey Satellite Technology Limited ("SSTL") in the United Kingdom, OHB Systems in Germany, an OHB Technology AG Company, and EADS Astrium with locations throughout Western Europe. Swedish Space Corporation is also able to compete in the small-satellite arena, particularly in the European market. In addition to private companies, there are a limited number of universities in the United States that have the capability to produce reasonably simple microsatellites; these include, Weber State in Ogden, Utah and Colorado University in Boulder, Colorado.

While we believe that our product and service offerings provide a wide breadth of solutions for our customers and prospective customers, some of our competitors compete across many of our product lines. Several of our current and potential competitors have greater resources, including technical and engineering resources. We are not aware of any established large companies (e.g., Northrop Grumman, Lockheed Martin, Boeing), which have expressed corporate goals to design and build inexpensive micro-spacecraft for a mission, which would be our direct competition.

THE LAURUS MASTER FUND, LTD. REVOLVING CREDIT FACILITY

On June 3, 2003, we 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, we 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 our option, in cash or through the issuance of our shares of common stock. The Convertible Note carries an interest rate of WSJ Prime plus 0.75% on any outstanding

balance. In addition, we are 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.

We filed a prior 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, we obtained the ability to pay amounts outstanding under the revolving credit facility in cash or shares of our common stock at the fixed conversion price of $0.55 per share on the first $1 million of principal.

PAGE 32

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 our 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, we 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 the date of conversion based on the restricted and thinly-traded nature of the 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 stock.

Availability of funds under the revolving credit facility is 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 our assets.

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. We 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 our 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 our 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, we are 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, 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 our common stock may be purchased by Laurus under such additional warrants.

PAGE 33

We may terminate our 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 we have: (i) provided Laurus with an executed release of all claims which we 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 us to Laurus if we terminate our Agreement after the occurrence of an Event of Default, as define in the agreements.

On March 31, 2004, we agreed to amend our Security Agreement and Secured Convertible Note with the Laurus Master Fund, Ltd. to change certain terms of the conversion price to allow for the next Five Hundred Thousand Dollars ($500,000) converted under the Convertible Note to be converted at eighty-five cents ($0.85) per share of common stock. Thereafter, the fixed conversion price shall be reset to equal 103% of the volume weighted average closing price of the common stock for the ten (10) trading days prior to the last day on which such five hundred thousand dollars ($500,000) has been converted. In exchange, Laurus agreed to waive certain over advance compliance provisions for six (6) months.

REGULATION

Our business activities are regulated by various agencies and departments of the U.S. government and, in certain circumstances, the governments of other countries. Several government agencies, including NASA and the U.S. Air Force, maintain Export Control Offices to ensure that any disclosure of scientific and technical information complies with the Export Administration Regulations and the International Traffic in Arms Regulations ("ITAR"). Exports of our products, services and technical data require either Technical Assistance Agreements ("TAAs") or licenses from the U.S. Department of State, depending on the level of technology being transferred. This includes recently published regulations restricting the ability of U.S.-based companies to complete offshore launches, or to export certain satellite components and technical data to any country outside the United States. The export of information with respect to ground-based sensors, detectors, high-speed computers, and national security and missile technology items are controlled by the Department of Commerce. The government is very strict with respect to compliance and has served notice that failure to comply with the ITAR and/or the Commerce Department regulations may subject guilty parties to fines of up to $1 million and/or up to 10 years imprisonment per violation. Our failure to comply with any of the foregoing

regulations could have serious adverse effects as dictated by the rules associated with compliance to the ITAR regulations. Also, our ability to successfully market and sell into international markets may be severely hampered due to ITAR regulation requirements. Our conservative position is to consider any material beyond standard marketing material to be regulated by ITAR regulations. This year we began an active and comprehensive internal and external ITAR training program provided by our regulatory consulting firm, Q International Group, and the Society for International Affairs, both for our employees and our Empowered Official, Mr. Slansky. We also introduced in 2003 an Internal Export Compliance Control Program for defense articles and defense services controlled by the U.S. Department of State under ITAR.

PAGE 34

In addition to the standard local, state and national government regulations that all businesses must adhere to, the space industry has specific regulations. In the U.S., command and telemetry frequency assignments for space missions are primarily regulated by the Federal Communications Commission for our domestic commercial products. Our products geared toward domestic government customers are regulated by the National Telecommunications Information Agency and any of our products sold internationally, if any, are regulated by the International Telecommunications Union. All launch vehicles that are launched from a launch site in the United States must pass certain launch range safety regulations that are administered by the U.S. Air Force. In addition, all commercial space launches that we might perform require a license from DOT. Satellites that are launched must obtain approvals for command and frequency assignments. For international approvals, the FCC and NTIA obtain these approvals from the ITU. These regulations have been in place for a number of years to cover the large number of non-government commercial space missions that have been launched and put into orbit in the last 15 to 20 years. Any commercial deep space mission that we might perform would be subject to these regulations. Presently, we are not aware of any additional or unique government regulations related to commercial space missions.

We are also required to obtain permits, licenses, and other authorizations under federal, state, local and foreign statutes, laws or regulations or other governmental restrictions relating to the environment or to emissions, discharges or releases of pollutants, contaminants, petroleum or petroleum products, chemicals or industrial, toxic or hazardous substances or wastes into the environment including, without limitation, ambient air, surface water, ground water, or land, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of pollutants, contaminants, petroleum or petroleum products, chemicals or industrial, toxic or hazardous substances or wastes or the clean-up or other remediation thereof. Presently, we do not have a requirement to obtain any special environmental licenses or permits.

We may need to utilize the Deep Space Network on some of our missions. The DSN is a U.S. funded network of large antennas that supports interplanetary spacecraft missions and radio and radar astronomy observations for the exploration of the solar system and the universe. The network also supports selected Earth-orbiting missions. The network is a facility of NASA, and is managed and operated for NASA by the Jet Propulsion Laboratory. The Telecommunications and Mission Operations Directorate manages the program within Jet Propulsion Laboratory. Coordination for the use of this facility is arranged with the Telecommunications and Mission Operations Command.

EMPLOYEES

At December 31, 2003, we employed approximately thirty (30) persons full and part-time, most of whom are aerospace, mechanical and electrical engineers. We expect to hire other personnel as necessary for completion of projects,

product development, quality assurance, sales and marketing, finance and administration. In addition, due to the nature of our business, we anticipate that it may become necessary to lay off employees whose work is no longer required to maintain operations in order to prevent cost overruns. We do not have any collective bargaining agreements with our employees, and we believe our employee-relations are good.

PAGE 35

INTELLECTUAL PROPERTY

We rely, in part, on licenses, patents, trade secrets and know-how to develop and maintain our competitive position and technological advantage. We intend to protect our intellectual property through a combination of patents, license agreements, trademarks, service marks, copyrights, trade secrets and other methods of restricting disclosure and transferring title. There can be no assurance that such applications will be granted. We have and intend to continue entering into confidentiality agreements with our employees, consultants and vendors; enter into license agreements with third parties; and, generally, seek to control access to and distribution of our intellectual property.

In August 1998, we acquired a license to intellectual property (including two patents and trade secrets) from an individual who had acquired them from the former AMROC, which specialized in hybrid rocket technology. We are obligated to issue warrants to this individual to purchase a minimum of 100,000 and a maximum of 3,000,000 shares of our common stock over ten years beginning at the inception of the agreement, depending on our annual revenues directly related to sales of hybrid technology-based products from the original technology acquisition. To date, we have issued warrants to purchase a total of 100,000 shares of our common stock under the agreement.

PAGE 36

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our 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 us; 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.

PAGE 37

OVERVIEW

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 microsatellites, nanosatellites and related subsystems, and 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 nanosatellites, hybrid rocket-based launch vehicles, Maneuvering and orbital Transfer Vehicles as well as safe sub-orbital and orbital hybrid rocket-based propulsion systems. Although we believe there will be a commercial market for our microsatellite and nanosatellite 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.

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 microsatellite 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 microsatellite distributed sensing experiment is intended to design and build up to six responsive, affordable, high performance microsatellites 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.

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 $115,000 of revenue was realized in the year ending December 31, 2003, with approximately $35,000 from engineering change orders and the remaining $80,000 from the contract. 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.

On July 24, 2003, we were awarded a contract by Lunar Enterprise of California ("LEC") for a first phase project to begin developing a conceptual mission and spacecraft design for a lunar lander program. The unmanned mission will be designed to put a small dish antenna near the south pole of the Moon. From that location it will be in near-constant sunlight for solar power generation, and should be able to perform multi-wavelength astronomy while communicating with ground stations on Earth. The contract value was $100,000 and was completed by November 2003. We believe that there is a possibility for a follow-on phase of $140,000 to further analyze launch opportunities, spacecraft design, trajectory possibilities, potential landing areas, available technologies for a small radio astronomy system, and communications and data handling requirements. This phase, if awarded, would be targeted for a mid-2004 completion. Although this project is currently unfunded, if the project were to proceed past the analysis stage, the total mission cost could exceed $50-$75 million. Again, we can give no assurance that the contract will be awarded to us. Revenues for the year ending December 31, 2003 were approximately $70,000.

Also on July 9, 2003, we were awarded a second contract by the Missile Defense Agency ("MDA") to explore the use of microsatellites ("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 $481,000 and $319,000 of revenue realized in the twelve-months ending December 31, 2003 and the three-months ending March 31, 2004, respectively. 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.

PAGE 39

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 year ending December 31, 2003 were approximately $50,000. 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 nanosatellite bus and subsystem designs. This AFRL SBIR contract, valued at 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 year ending December 31, 2003 were approximately $40,000. 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 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. There were no revenues for the year ending December 31, 2003. 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 negotiated an extension of Phase II with AFRL in order to complete the work and the related option was initiated on May 3, 2004. The option work has begun, since we met certain milestones to the satisfaction of the AFRL project manager. The additional funding to complete AFRL Phase II will come from the $1 million option; thereby, requiring a reduction in the original scope of the option. Revenues for the twelve-months ending December 31, 2003 and the three-months ending March 31, 2004, respectively, were approximately $997,000 and $412,000 for AFRL Phase II.

PAGE 40

In November 1999, we won a $4.9 million turnkey mission contract by the Space Sciences Laboratory ("SSL") at the University of California at Berkeley. We were competitively selected by the University of California at Berkeley/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 the University of California at Berkeley, 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 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 the University of California at Berkeley with new and interesting data. The University of California at Berkeley requested to extend the program and we recently negotiated a new time and materials contract in the form of a purchase order with the University of California at Berkeley for continuing support of this project. Revenue for the year ending December 31, 2003 was approximately $356,000. Revenue for the three-months ending March 31, 2004 and 2003 was approximately $12,000 and $112,000, respectively.

On June 18, 2001, we entered into a relationship with two individuals (doing business as EMC Holdings Corporation ("EMC")) whereby EMC was to provide certain consulting and advisory services to us. EMC received the first installment of 500,000 shares of our common stock on June 26, 2001. Total expense for the initial stock issuance through September 30, 2001 was

approximately $455,000. Pursuant to a demand for arbitration filed by us on November 7, 2001, we sought the return of all or a portion of the shares issued to EMC. Following a three-day arbitration in May and June 2002, on July 17, 2002, an interim award was issued in favor of us against EMC, ordering the return of the initial installment of our 500,000 shares and denying EMC's own claim for $118,000. On October 22, 2002, a tentative final award was issued in our favor including an award of approximately $83,000 in attorney and arbitration fees to us. The tentative final ruling became effective on October 29, 2002, and has been submitted to the Superior Court of California, Orange County, for entry of judgment. Because collection of the attorney and arbitration fees award is not assured, we expensed all of our fees related to this matter. Any recovery of the fees will be recorded as income in the period they are received; however, at this time, we do not expect any recovery and in June 2003, we ceased efforts to recover the awarded fees, as it was determined that the cost to pursue collection exceeded the likelihood of collection. The return of our 500,000 shares, as provided in the interim award issued on July 17, 2002, was recorded in the third quarter of 2002 as a reversal of the original expense recorded. Because the original expense was not recorded as an extraordinary item, the reversal of the expense did not qualify as an extraordinary item.

RESULTS OF OPERATIONS

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

YEAR ENDED DECEMBER 31, 2003 -VS.- YEAR ENDED DECEMBER 31, 2002

During the year ending December 31, 2003, we had net sales of approximately $2,960,000 as compared to net sales of approximately $3,370,000 for the same period in 2002. Sales declined primarily due to government delays in finalizing the follow-on contracts for AFRL and MDA and to customer delays on SpaceShipOne. Sales in 2003 reflected the substantial completion of CHIPSat and the completion of the original SpaceShipOne contract, AFRL Phase I and MDA Phase I, while a new exclusive proprietary propulsion contract (SpaceShipOne), began on October 2, 2003, a new contract with MDA began on July 9, 2003, a new contract with AFRL began on July 9, 2003 and a new contract with Lunar Enterprises began on July 24, 2003. The total value of the MDA, AFRL and Lunar Enterprises contracts were $800,000, $1.4 million and $100,000, respectively. Revenues for the year ending December 31, 2003 were comprised of approximately $29,600 and $997,000 from AFRL Phase I and II, respectively, $397,000 and $115,000 from the original and new exclusive proprietary propulsion contracts (SpaceShipOne), respectively, $250,000 and $481,000 from MDA Phase I and II, respectively, $356,000 from the CHIPSat program, $100,000 from the contract by Lunar Enterprises of California and approximately $220,400 from all other programs. During the same period of 2002, sales were comprised of approximately $1.7 million from the CHIPSat program, approximately $1.2 million from the original SpaceShipOne propulsion development program, approximately $300,000 from the completion of our outstanding government grants, approximately $70,000 from Phase I of the AFRL project and approximately $130,000 from all other programs.

For the year ending December 31, 2003, we had costs of sales (direct and allocated costs associated with individual contracts) of approximately $2,415,000, or 82% of net sales, as compared to approximately $3,348,000 or 99% of net sales, during the same period in 2002. The decrease in cost of sales was primarily due to a lower overall cost structure, combined with the implementation of stronger cost controls and project monitoring. Also, we altered our cost allocation method in the second quarter of 2003 as we completed CHIPSat, our main fixed price contract at the time, and began work on our new AFRL and MDA cost plus contracts. 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 year ending December 31, 2003 was 18% of net sales, an increase of 16% of net sales, as compared to 2% of net sales for the period in 2002.

We experienced an increase of approximately $1,364,000 in operating expenses from approximately $66,000, or 2% of net sales, in the year ending December 31, 2002 to approximately $1,430,000, or 48% of net sales, for the year ending December 31, 2003. 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. In 2002, we experienced a one-time reversal for the EMC transaction (see EMC Holdings Corporation transaction in MD&A Overview Section above). The increase in operating expenses for the year ending would have been approximately $905,000, rather than the stated $1,360,000 increase, without the one-time EMC reversal. The following comparisons are based on total operating expenses excluding the effects of the one-time EMC reversal.

- Marketing and sales expenses accounted for approximately 15% of the increase in operating expenses, from approximately $258,000, or 8% of net sales, for the year ending December 31, 2002, to approximately $395,000, or 13% of net sales, during the same period in 2003, mainly due to our decision to expand our marketing and sales department and add a Vice President of Marketing and Product Development. Although our Vice President of Marketing and Product Development is no longer with us, our CEO, Mr. Benson is leading our marketing & sales efforts and most of his expenses are being charged to this department.

- Research and development ("R&D") expenses accounted for approximately 31% of the increase in operating expenses. We began incurring R&D expenses of approximately $281,000, or 10% of net sales, during the year ending December 31, 2003. Approximately $192,000 of R&D was in connection with our hybrid rocket propulsion design system and technologies and the remaining $89,000 was part of our satellite bus design and development.

Approximately 1% of the increase in operating expenses came from stock and stock option-based compensation expense. During the year ending December 31, 2003, we had an increase in stock and stock option based compensation expense from approximately ($452,000), or (14%) of net sales, in 2002 to approximately $9,000 or 0% of net sales during the same period in 2003. This increase was mainly due to the reversal of stock compensation from the EMC arbitration ruling as noted above.

- G&A expenses accounted for approximately 53% of the increase in operating expenses. The increase in G&A expenses from approximately $261,000 for the year ending December 31, 2002 to approximately $746,000 for the same period in 2003 was primarily due to new rent charges of approximately $291,000 (we owned the building in 2002 and incurred interest expense on loans but not rental payments) plus one-time revolving credit facility expenses of approximately $42,000 and an increase in G&A labor expense with the hiring of our Chief Financial Officer, offset by a reduction in G&A labor expense of $92,000 primarily due to the loss of our Vice President of Operations.

  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 year ending December 31, 2003 and 2002 was

approximately $91,000, or 3% of net sales, and $263,000, or 8% of net sales, respectively. The decrease was due to the building sale on January 31, 2003, which eliminated building debt and reduced overall interest on the notes associated with the building. We continue to pay interest expense on certain capital leases and settlement notes. In addition, we accrued interest expense related to our related party note, convertible debentures and our revolving credit facility. In the years ending December 31, 2003 and 2002, the accrued interest on our related party note was approximately $47,000 and $45,000 respectively. We also accrued and paid approximately $18,000 of interest on our convertible notes and accrued approximately $14,000 of interest, $42,000 of fees and $126,000 of non-cash loan fees on our revolving credit facility with Laurus for the year ending December 31, 2003.

PAGE 43

- In conjunction with our convertible notes, we recorded a convertible note debt discount of $475,000 related to warrants that accompanied the convertible debt issue in 2002; however, since we made a partial repayment and the note holders converted the remaining balance and forfeited half of their warrants, the debt discount amount was reduced from $475,000 to $237,500. The reduction is exclusively attributable to forfeiture of half of the original warrants. During the year ending December 31, 2003, the convertible debt was eliminated. A debt discount adjustment of approximately $234,000 was made and the ending balance of $112,500 was recorded on the statement of operations for the year.

- We recognized approximately $107,500 of the deferred gain on the sale of the building during the year ending December 31, 2003 and we will continue to amortize the remaining deferred gain of approximately $1,065,000 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.

- 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 $258,000 for the year ending December 31, 2003. We anticipate additional expenses related to similar note to equity conversions in the quarters ahead.

During the year ending December 31, 2003, we incurred a net loss of approximately $1,246,000, or 42% of net sales, compared to a net loss of approximately $376,000, or 11% of net sales, for the same period in 2002. During the year ending December 31, 2003, we incurred an EBITDA (earnings before interest taxes depreciation and amortization) of approximately