SPACEDEV INC
Form SB-2
July 25, 2003

As filed with the Securities and Exchange Commission on July 25, 2003.

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.

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	AMOUNT TO BE REGISTERED (1)	PROPOSED MAXIMUM OFFERING PRICE PER SHARE	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE
Common Stock, $0.001 par value, underlying Convertible Note	1,818,182 (2)	0.550 (3)	1,000,000
Common Stock, $0.001 par value, underlying Warrants	125,000	0.630 (3)	78,750
Common Stock, $0.001 par value, underlying Warrants	50,000	0.690 (3)	34,500
Common Stock, $0.001 par value, underlying Warrants	25,000	0.800 (3)	20,000
Common Stock, $0.001 par value, underlying Warrants	158,333	0.750 (3)	118,750
Common Stock, $0.001 par value, underlying Warrants	23,419	0.854 (3)	20,000
Common Stock, $0.001 par value, underlying Warrants	818,248	0.490 (3)	400,942
Common Stock, $0.001 par value, underlying Warrants	196,079	0.510 (3)	100,000
Total	3,214,261		1,772,941

(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 3,214,261 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.

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 July 25, 2003

PROSPECTUS

SPACEDEV, INC.

3,214,261 SHARES OF COMMON STOCK

This prospectus relates to the resale by security holders of up to 3,214,261 shares of our common stock underlying (1) common stock purchase warrants issued in a prior private placement of our securities to accredited investors representing 1,196,079 shares (the "Warrants"), (2) a three-year secured convertible note, or the Convertible Note, issued to Laurus Master Fund, Ltd. ("Laurus") in the principal amount of $1,000,000, and (3) a common stock purchase warrant for up to 200,000 issued to Laurus in relation to the Convertible Note (the "Laurus Warrant"). 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 $16,143.

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 July 17, 2003, was $0.85 per share.

Our principal offices are located at 13855 Stowe Drive, Poway, California 92064, and our telephone number is (858) 375-2000.

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 6.

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 July 25, 2003.

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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 1,818,182 shares of our common stock that are issuable upon conversion of a three-year Secured Convertible Note, or the Convertible Note, in the principal amount of $1,000,000, and up to 200,000 shares of common stock that are issuable upon the exercise by Laurus of a warrant, called the Laurus Warrant in this prospectus, that we provided to Laurus in connection with the strategic financing. In addition, this prospectus covers the resale of up to 1,196,079 shares of common stock issuable upon exercise of outstanding warrants issued in a private placement offering from November 2000 to February 2003, 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 micro-satellites, nano-satellites and related subsystems, 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 nano-satellites, hybrid rocket-based orbital Maneuvering and orbital Transfer Vehicles ("MTVs") 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	1,818,182 shares
Common stock underlying the Laurus Warrant and the Warrants	1,396,079 shares
Common Stock Outstanding after Exercise of outstanding Warrants, the Laurus Warrant and the Convertible Note	18,553,168 shares

Termination of the Offering	The offering will conclude upon the earlier of the sale of all 3,214,261 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 6, as well 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, 2002 and 2001 and as of and for the three months ended March 31, 2003 and 2002. The financial data as of and for the fiscal years ended December 31, 2002 and 2001 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 ended March 31, 2003 and 2002 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 ended March 31, 2003 and 2002. Our historical results are not necessarily indicative of results to be expected for any future periods.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS DATA

	YEARS ENDING	THREE MONTHS

	DECEMBER 31, 2002	2001	MARCH 31,
Net revenues	$ 3,370,118	$ 4,099,094	$
Loss from operations	$ 13,920	$(1,551,620)	$ (
Net loss	$ (376,160)	$(1,855,871)	$ (
Basic loss per share	$ (0.03)	$ (0.13)	$
Weighted average shares outstanding, basic	14,744,423	14,440,354	15,

CONDENSED CONSOLIDATED BALANCE SHEET DATA (IN THOUSANDS):

	December 31, 2002	December 31, 2001	March 31, 2003	-
Cash and cash equivalents	27,648	211,637	210,856	
Working capital deficit	(197,381)	(1,002,390)	(311,551)	
Total assets	3,811,957	3,013,651	917,532	
Long-term debt, net of current portion	661,314	2,986,270	608,895	
Stockholders' Deficit	(1,767,459)	(1,489,235)	(1,846,605)	

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 PLANS TO BECOME PROFITABLE DEPEND ON OUR ABILITY TO INCREASE REVENUES, WHILE CONTROLLING COSTS IN A VARIETY OF AREAS AND IMPROVING OUR PROJECT MANAGEMENT EXPERTISE.

At December 31, 2002 and 2001, our auditors expressed a formal auditors' opinion that our prior financial position raised "substantial doubt about [our] ability to continue as a going concern." We incurred net losses of $376,160, $1,855,871 and $505,087 for the fiscal years ended December 31, 2002 and 2001 and the three-months ending March 31, 2003, respectively. We provided (used)

cash in operations totaling $706,973, ($68,471) and $731,054 for the fiscal years ending December 31, 2002 and 2001 and the three-months ending March 31, 2003, respectively. During the past year we have significantly reduced our operating expenses. However, in order to achieve profitability, we must increase our revenues while continuing to control our expenses and improve our project management expertise. We are continuing to implement cost containment measures in an effort to reduce our cash consumption from operations, and we are working to increase sales by taking on additional design and development projects. The results of these combined efforts have reduced our cash used in operations to approximately $340,000 per month.

We intend to continue these combined efforts with the goal of generating positive cash flow from operations in the quarter ending December 31, 2003. To accomplish this goal, we are tailoring our cost containment measures and focusing our short-term selling efforts on government contracts. However, there can be no assurance that we will achieve positive cash flow during this timeframe. Furthermore, because some of the areas of expense cutting, such as sales and marketing and research and development, involve activities that we ordinarily undertake with the expectation that they will contribute to future revenues, obtaining and maintaining profitability may be difficult, even with reduced expenses. Even if near-term profitability can be achieved through cost reductions, it will not be sustainable if the effect of cost reductions is to impede future revenue growth.

If adequate funds from operating activities are not available, we may be required to delay, scale back or eliminate portions of our operations and product development efforts or to obtain funds through arrangements with strategic partners or others that may require us to relinquish rights to certain portions of our technologies or potential products or to consummate additional funding. This funding 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 as needed, or that such funding will be available on terms favorable to us. 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 will 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, 2003, December 31, 2002 and 2001, we had a working capital deficit of $311,551, $197,381 and $1,002,390, respectively, and an accumulated deficit of $11,076,797, $10,571,709 and $10,195,547, respectively. As of those dates, we had $210,856, $27,648 and $211,637, respectively, in cash and cash equivalents and $220,841, $82,325 and $290,615, 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 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. Also, we need to obtain the consent of Laurus for future equity financing. At a minimum, we expect covenants to restrict our ability to pay dividends on our common stock.

IF A SIGNIFICANT PORTION OF THE SECURED CONVERTIBLE NOTE 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, is convertible by Laurus into up to 1,818,182 shares of our common stock at an initial

fixed conversion price of $0.55 per share, to the extent that we have drawn funds on the credit facility and not repaid those funds. This number of shares represented approximately 11.9% of the 15,338,907 shares of our common stock that were outstanding on July 17, 2003. As a result, if the entire principal balance of the Note were converted at the initial conversion price, 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 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 Note, 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 Note.

WE CAN GIVE NO ASSURANCE OF THE SUCCESSFUL OR TIMELY DEVELOPMENT OF PRODUCTS.

Despite our success in designing, launching and monitoring our first micro-satellite, 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 micro-satellites in the near-term with a long-term commercial market developing for private manned and unmanned space exploration. Because micro-satellites 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 NOTE MAY NOT NECESSARILY PREVENT SUBSTANTIAL DILUTION OF THE VOTING POWER AND VALUE OF YOUR INVESTMENT.

The contractual limitations that restrict Laurus' ability to convert the Note into shares of our common stock are limited in their application and effect and may not prevent dilution of your investment. 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.

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 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 have only recently launched our first micro-satellite, CHIPSat, and are

developing applications for our other technologies and products. We intend to provide micro-satellites to early adopters, primarily the U.S. military, and hybrid rocket motors to government and commercial customers. 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.

A launch failure could adversely affect our cash flow, since a large portion of customer payments is often contingent upon a successful launch. Micro-satellite launches are subject to significant risks, including causing disabling damage to or loss of a micro-satellite. Delays in the launch could also adversely affect our revenues as a 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, micro-satellite components, or related ground systems; delays in receiving the license necessary to operate the micro-satellite 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 micro-satellites 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 are developing our technology into products for micro-satellites and hybrid rocket motors. In addition, we are investigating other applications of our technology and other markets for our 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 director of engineering, Jeffrey Janicik. 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 ("STI") 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 ("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 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") regulates 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. These regulations are well understood by us. 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 July 17, 2003, the high and low closing price of a share of our common stock was $0.85 and $0.29, 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.

As of March 31, 2003, we had available net operating loss carryforwards of $2,900,000 for federal income tax purposes and $1,672,000 for state income tax purposes. California net operating loss carryforwards are suspended from use for 2003 and there is no guarantee that the suspension will not be extended. Due to the "change in ownership" provisions of the Tax Reform Act of 1986, our net operating loss carryforwards may be subject to an annual limitation on the utilization of these carryforwards against taxable income in future periods if a cumulative

change in ownership of more than 50% occurs within any three-year period. To the extent we are unable to fully use these net operating loss carryforwards to

offset future taxable income, we will be subject to income taxes on future taxable income, which will decrease our 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 approximately $1.1 million, consisted primarily of the income tax benefits from net operating loss carryforwards, amortization of goodwill and research and development credit carryforwards. The federal and state tax loss carry forwards will expire through 2022 unless previously utilized. 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 decreased approximately $300,000 during quarter ended March 31, 2003, from $1.4 million at December 31, 2002 to $1.1 million at March 31, 2003. Please refer to our consolidated financial statements, which are a part of this prospectus, for further information regarding our liquidity and capital resources.

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 July 17, 2003, our executive officers and directors and their family members together beneficially owned approximately 74.8% of the issued and outstanding shares of our common stock. As a result, these persons have the ability to exert significant 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 intend to protect our intellectual property through a combination of license agreements, trademark, service mark, copyright, trade secret laws 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 product 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 the production of our products or in the provision of our services. We have not experienced material difficulty in obtaining product

components or necessary parts and equipment and believe that alternative sources of supply would be available, although increased costs and possible delays could be incurred in securing alternative sources of supply.

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 including, but not limited to, recruiting engineering talent quickly and financing the increased costs associated with rapid growth. 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 1,557,941 shares of our common stock if all of our outstanding warrants, outside of the warrants in this offering, are exercised. In addition, as of July 17, 2003, we have outstanding stock options to purchase an aggregate of 7,398,387 shares of our common stock, including currently 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 (5,099,347 shares) represents approximately 33.2% of our issued and outstanding shares of common stock as of July 17, 2003. 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.

OUR COMMON STOCK IS SUBJECT TO PENNY STOCK RULES.

Our common stock is subject to Rule 15g-1 through 15g-9 under the Securities Exchange Act of 1934, as amended, which imposes certain sales practice requirements on broker-dealers which sell our common stock to persons other than established customers and "accredited investors" (generally, individuals with net worths in excess of $1,000,000 or annual incomes exceeding $200,000 (or $300,000 together with their spouses)). For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to the sale. This rule adversely affects the ability of broker-dealers to sell our common stock and purchasers of our common stock to sell their shares of such common stock.

Additionally, our common stock is subject to the Securities and Exchange Commission regulations for "penny stock." Penny stock includes any non-Nasdaq equity security that has a market price of less than $5.00 per share, subject to certain exceptions. The regulations require that prior to any non-exempt buy/sell transaction in a penny stock, a disclosure schedule set forth by the Securities and Exchange Commission relating to the penny stock market must be delivered to the purchaser of such penny stock. This disclosure must include the amount of commissions payable to both the broker-dealer and the registered representative and current price quotations for the common stock. The regulations also require that monthly statements be sent to holders of penny stock which disclose recent price information for the penny stock and information of the limited market for penny stocks. These requirements adversely affect the market liquidity of our 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 return to profitability 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, up to an aggregate of 2,018,182 shares of our common stock consisting of up to 1,818,182 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 $0.55 per share and up to 200,000 shares of our common stock issuable upon exercise of the Laurus Warrant. Laurus may 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 July 17, 2003. 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 2,018,182 shares of common stock outstanding as of July 17, 2003. Actual ownership of the shares is subject to conversion of the Convertible Note and exercise of the Warrant.

SELLING SECURITY HOLDER	SHARES OF COMMON STOCK BENEFICIALLY OWNED PRIOR TO OFFERING NUMBER		PERCENTAGE	SHARES OF COMMON STOCK BEING REGISTERED	SHARES OF COMMON STOCK BENEFICIALLY OWNED AFTER OFFERING (1) NUMBER	
LAURUS MASTER FUND, LTD.	2,018,182	(2)	1.3	2,018,182		0

(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. For purposes of this table, we assume Laurus converts the full $1 million under the Secured Convertible Note. Under such Rule 13d-3, 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 Secured Convertible Note is subject to the amount drawn under the note and, if less than $1 million is drawn and converted, the number of shares available to Laurus could be materially less but not more than the number estimated in the table. 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 1,196,079 shares of common stock through this prospectus, subject to exercise of warrants issued to them in a private placement that was exempt from registration under Section 4(2) and Rule 506 of the Securities Act of 1933.

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), to our knowledge, 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 (6)
Charles H. Lloyd	(1)	50,000	25,000	25,000	0.13%
Lunar Enterprises		133,334	66,667	66,667	0.36%
Craig Haffner		66,666	33,333	33,333	0.18%
Alex Duncan		95,166	33,333	61,833	0.33%
Arthur Benson	(2)	128,470	64,235	64,235	0.35%
Curt Dean Blake	(3)	61,224	30,612	30,612	0.16%
John Gross		61,224	30,612	30,612	0.16%
Edward Cuthbert		102,040	51,020	51,020	0.27%
J. Mark Grosvenor	(4)	1,330,376	665,188	665,188	3.59%
Christopher McKellar	(5)	392,158	196,079	196,079	1.06%

(1) Mr. Lloyd acted as Chief Financial Officer and Chief Operating Officer of SpaceDev, Inc., and Chief Executive Officer of Integrated Space Systems, Inc., our wholly owned subsidiary, during the period from November 1999 to June 2002. In addition to the Warrants, Mr. Lloyd owns 25,000 shares of our common stock and holds options to purchase 1,000,000 shares of our common stock, 250,000 of which expires in 2004 and 750,000 shares of which expires in 2005.
(2) Mr. Arthur Benson is the brother of our Chief Executive Officer, James W. Benson. In addition to the Warrants, Arthur Benson holds 64,235 shares of our common stock.
(3) Mr. Blake is a current member of our board of directors. In addition to the Warrants, Mr. Blake holds 30,612 shares of our common stock and options to purchase an additional 79,706 shares of our common stock.
(4) Mr. Grosvenor is a current member of our board of directors. Mr. Grosvenor was appointed to the board of directors after he acquired Warrants and common shares in our private placement offering. In addition to the Warrants, Mr. Grosvenor holds 665,188 shares of our common stock and options to purchase an additional 19,615 common shares.
(5) Mr. McKellar is the owner of our principal business facilities. Upon sale of the building to Mr. McKellar, we executed a leaseback of the building for a term of 10 years. In addition to the Warrants, Mr. McKellar holds 196,079 shares of our common stock.
(6) For purposes of calculating percentage of ownership, we assumed the exercise of all of the warrants, 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 July 17, 2003 plus shares issuable upon exercise of the Warrants, the Convertible Note and the Laurus Warrant, or 18,553,168 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.

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 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.

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.

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.

USE OF PROCEEDS

We will not receive any proceeds from the sale of the shares of our common stock offered by Laurus under this prospectus. Upon exercise of the Warrant, we will receive proceeds from the Warrant holder; however, upon selling the common

stock underlying the Secured Convertible Note and/or the Warrant, 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" and in our General Registration Statement on Form 10SB12G/A filed January 28, 2000.

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; 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; 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 systems, products and services. We are currently focused on the commercial development of low-cost micro-satellites, nano-satellites and related subsystems, 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 nano-satellites, hybrid rocket-based orbital Maneuvering and orbital Transfer Vehicles ("MTVs") 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.

Our approach is to provide smaller spacecraft -(generally 250 kg mass and less) and compatible small hybrid propulsion space systems to commercial, university and domestic 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 at reduced costs.

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 ("AFRL"), The Boeing Company, the California Space Authority ("CSA"), the Jet Propulsion Laboratory ("JPL"), Lockheed Martin, the National Reconnaissance Office ("NRO"), and the University of California at Berkeley ("UCB") 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 ("ISS"), in San Diego. ISS was fully integrated into SpaceDev. Most of the ISS employees were former launch vehicle engineers and managers who worked for General Dynamics in San Diego. As SpaceDev employees, they primarily develop products based on hybrid rocket motor technology.

In August 1998, we acquired 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 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 ("JPL") to perform a mission and spacecraft feasibility assessment study for the proposed 200-kg Mars

MicroMissions. The final report was delivered to JPL in March 1999 and, as a result, we are now able to offer lunar and Mars commercial deep-space missions based on this innovative space system design.

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

In November 1999, we won a $4.9 million turnkey mission contract by the Space Sciences Laboratory ("SSL") at University of California, Berkeley ("UCB"). We were competitively selected by UCB/SSL to design, build, integrate, test and operate, for one year, a small NASA-sponsored scientific, Earth-orbiting spacecraft called CHIPSat. CHIPSat is the first mission of NASA's low-cost University-Class Explorer ("UNEX") series. 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. In 2000, we reviewed the contract status at year-end and determined that the total estimated costs at the end of the program would exceed the likely revenue. As a result, we accrued a loss of approximately $860,000 based on the expected contract modification of $600,000, which was approved on June 15, 2001. On November 28, 2001, a second contract modification was signed with UCB, which added approximately $1.2 million to the contract as well as an increase in contract scope. This increased the total contract revenue to approximately $6.8 million and reduced the total expected loss on the contract to approximately $460,000. During 2002, an additional contract modification for approximately $400,000 was signed, which also increased the contract value and scope to the current value of the CHIPSat project of approximately $7.4 million, further reducing the total expected loss on the contract to approximately $514,000, most of which could have been recorded as research and development costs associated with the development of our ongoing satellite design and development programs. As of December 31, 2002, approximately 97% of the total contract costs were expended and the remaining loss on the balance sheet at year-end totaled approximately $11,000. The CHIPSat program generated approximately $2.1 million and $3.2 million of revenue in 2000 and 2001, respectively. Revenues for 2002 were approximately $1.7 million and are expected to be approximately $400,000 in 2003. We are currently receiving monthly payments on the contract according to a preset payment schedule detailed in the contract. The CHIPSat contract is expected to conclude in January 2004.

On March 22, 2000, the California Spaceport Authority and the California Space and Technology Alliance ("CSTA") notified us that we had been awarded 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 facilities were completed in January 2001.

In July 2000, the NRO 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 NRO has helped fund two innovative hybrid rocket motor products:

- a family of small versatile orbital Maneuver and Transfer Vehicles ("MTVs") using clean, safe hybrid rocket propulsion technology; and,

- a protoflight hybrid propulsion module for a 50-kg class

micro-satellite.

Both of those contracts were successfully completed.

In September 2001, we were awarded a contract for a proprietary hybrid propulsion research program valued in excess of $1 million. As a part of that program, we are competing with another party to design a space propulsion system. The entire contract, which will be awarded based upon the submitted designs, is valued at approximately $2.2 million. We believe that the award could lead to a long-term market for our hybrid propulsion technology. Due to the highly competitive, confidential and market-sensitive nature of the contract, we are unable to release more detailed information on the project until the contract has been awarded in full. However, we do believe this new contract is indicative of an increased demand for our hybrid motor technology and expertise in the space industry. Work on this project generated approximately $300,000 and $1.2 million of revenue in 2001 and 2002, respectively.

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. Plans for development of this business in Oklahoma are currently on hold.

On April 30, 2002, we were awarded Phase I of a contract to develop a Shuttle-compatible propulsion module for the Air Force Research Lab ("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 contract. In addition to the Phase I and Phase II awards, there is an option worth approximately $1 million. The option has been awarded and work will begin once certain milestones are met to the satisfaction of the AFRL project manager.

On April 30, 2002, we were awarded Phase I of a contract to develop a Shuttle-compatible propulsion module for the Air Force Research Lab ("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 contract. In addition to the Phase I and Phase II awards, there is an option worth approximately $1 million. The option has been awarded and work will begin once certain milestones are met to the satisfaction of the AFRL project manager.

On July 9, 2003, we were awarded a Phase I contract to develop micro- and nano-satellite bus and subsystem designs. This AFRL Small Business Innovation Research (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.

On July 9, 2003, we were awarded a Phase I SBIR contract by 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 also valued at approximately $100,000, is a fixed price, milestone-based agreement, which should be completed within one year. Both SBIRs have the possibility of Phase II carry-forward 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 in national missile defense. In January, SpaceDev launched CHIPSat, our high-performance low-cost satellite. Our microsats are operated over the Internet and are capable of pointing and tracking targets in space or on the ground. This study will explore 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 value is $800,000, and the total value of our microsatellite studies for MDA is over $1 million this year.

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. We will 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 study picks up where we left off from our original 1997 Near Earth Asteroid Prospector (NEAP) mission design, our 1999 Mars MicroMission design for NASA's JPL, and our work in 2001 with Boeing on possible commercial lunar orbiter missions. This contract is valued at $100,000, is a fixed price, milestone-based agreement, which should be completed by November 20, 2003.

BUSINESS STRATEGY

Our strategy is based on the belief that advancements in technology and the application of standard processes 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 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 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;

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

o Produce and fly commercial missions, in conjunction with partners and investors, throughout the inner solar system and be "first to market" in the commercial beyond earth orbit "space"; and

o 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:

o 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;

o Lowers total project costs and therefore provides greater value and increases return on investment for us and our customers; and

o Creates barriers to entry for 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:

o Our Products - Microsatellites & Nanosatellites, BD-II Spacecraft Bus, MTV (orbital maneuvering and transfer vehicle) and Hybrid Propulsion Systems;

o Our Subsystem Products - MFC (miniature flight computer), MS-VOS (micro space vehicle operating system), PC-DS (power conditioning and distribution system) and MTS (miniature S-band transponder); and,

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

These products and services are being marketed and sold directly into domestic government, university 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 JPL Mars MicroMission mission design contract.

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. 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 space-mission solutions involving micro-satellites (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, domestic government and university 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 developed this product in 1999, when we were selected as the mission designer, spacecraft bus provider, integrator and mission operator of the University of California, Berkeley ("UCB") Space Sciences Laboratory's ("SSL") Cosmic Hot Interstellar Plasma Spectrometer ("CHIPS") mission. CHIPSat was launched at 4:45 PM PST on January 12, 2003 from Vandenberg Air Force Base in California. The satellite achieved 3-axis stabilization with all individual components and systems successfully operating and continues to work well in orbit.

Orbital Maneuvering and Transfer Vehicle ("MTV") - Our MTV system is a family of small, affordable, elegantly simple, throttleable, and restartable propulsion and integrated satellite products. Our MTV can be used as a standard propulsion module to transport a customer's payload. The MTV provides 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 transfer.

Hybrid Rocket Propulsion System - We provide a wide variety of safe, clean, simple, reliable, inexpensive 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.

Our Subsystem Products

Miniature Flight Computer ("MFC") - Our MFC is a high performance 300 million instructions per second ("MIPS") general-purpose 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 2 to 6 watts of power, depending on its tasks. Our MFC has successfully passed manufacturing and environmental testing for low earth orbit ("LEO") missions and is ready for civil, military and commercial spacecraft and launch vehicle applications.

Micro Space Vehicle Operating System ("MS-VOS") - Our MS-VOS is a small, fast, modular and layered operating system, similar to the operating systems of microcomputers. The modular nature of our MS-VOS 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 MS-VOS 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. The MC-OS satellite command and control is managed via user commands, batched command scripts and timed command scripts. Data acquisition is accomplished by mapping the input data stream (bytes, words or floats) to MC-OS variables. The mapping is accomplished by selecting a frame offset and data type for each MC-OS variable. Other MC-OS components include 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 ("MST") and Miniature S-Band Receiver ("MSR") are a cost-effective solution for low cost and low mass spacecraft. The MST and MSR 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 in orbit since the January 12, 2003 launch of CHIPSat, the first mission to be funded through NASA's University-Class Explorer ("UNEX") Program. The MST and MSR designs provide flexibility to meet customer requirements and options. Both units are designed to operate in most present day thermal, launch, and on-station low-Earth-orbit ("LEO") spacecraft environments.

Our Services

Mission Analysis and Design - We 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. Many of our products and services are now qualified and capable to assist with missions that orbit the earth, travel to another planetary body, or cruise through space taking measurements and transmitting valuable data back to Earth.

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 ("MFC") is only 24 cubic inches and provides 300 million instructions per second ("MIPS") of processing power versus a competitor's more "traditional" solution that requires about 63 cubic inches and only provides 10 MIPS.

Microsatellite & Nanosatellite Launches - To support the growth in customer demand within the small satellite market, we are working with several 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, and 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 perform all the tasks required for the customer to get to orbit and to get their data.

Mission Control and Operations - 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. The Cosmic Hot Interstellar Plasma Spectrometer Satellite ("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 micro-satellites can be designed to communicate directly with each other. Providing any one satellite/node in this network is in line-of-sight with any ground station at any given time, the entire constellation would 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. Furthermore, we have not experienced difficulty in our ability to obtain our parts or component materials, nor do we expect this to be an issue in the future.

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 micro--satellites, unmanned deep space micro-spacecraft and micro-satellite subsystems as well as software systems comes from other small companies such as AeroAstro or MicroSat Systems. The most established international competitor is Surrey Satellite Technology Limited ("SSTL") in the United Kingdom. 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 micro-satellites. These include Weber State in Utah and Arizona State University ("ASU") in Phoenix.

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.

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 ("STI") 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 ("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.

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 ("FCC") for our domestic commercial products. Our products geared toward domestic government customers are regulated by the National Telecommunications Information Agency ("NTIA") and any of our products sold internationally, if any, are regulated by the International Telecommunications Union ("ITU"). 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 deep 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 ("DSN") on some of our missions. The DSN is an international network of 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 ("JPL"). The Telecommunications and Mission Operations Directorate ("TMOD") manages the program within JPL. Coordination for the use of this facility is arranged with the Telecommunications and Mission Operations Command ("TMOC").

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., or Laurus. In this prospectus, we refer to these agreements, as the Agreement, which we filed on Form 8-K dated June 18, 2003. Pursuant to the Agreement, we received a $1 million revolving credit facility in the form of a three-year Convertible Note secured by our assets. The net proceeds from the Convertible Note shall be used for our general working capital needs. Advances on the Convertible Note may be repaid at 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.

Once the shares are registered with the Securities and Exchange Commission ("SEC") for public resale and the then current market price is 118% of the fixed conversion price. we will have an option to pay amounts outstanding under the revolving credit facility in shares of our common stock at the fixed conversion price of $0.55 per share on the first $1 million of principal.

The Convertible Note includes a right of conversion in favor of Laurus. If Laurus exercises its conversion right at any time or from time to time at or prior to maturity, the Convertible Note will be 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 Agreement). The fixed conversion price will be adjusted after conversion of the

first $1 million to 103% of the then fair market value of our common stock ("Adjusted Fixed Conversion Price").

Availability of funds under the revolving credit facility will be based on our accounts receivables. The revolving credit facility will be secured by all of our assets, except for an initial three (3) month period during which Laurus will permit a credit advance up to $300,000, which amount might otherwise exceed eligible accounts receivable during the period.

In conjunction with this transaction, Laurus was paid a fee of $20,000 for the first year (and will be required to pay a continuation fee of $10,000 for each year thereafter), which fee will be expensed as additional interest expense. In addition, Laurus received a warrant to purchase 200,000 shares of our common stock, as stated herein. The value of the warrant of approximately $98,475 will be treated as additional interest expense and will be amortized over the three-year life of the Convertible Note, unless sooner terminated. 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. The value of the warrant will be determined, if and when issued, and will be treated as additional interest expense and will be amortized over the remaining term of the Convertible Note, unless sooner terminated. No more than an aggregate of 100,000 shares of our common stock may be purchased by Laurus under such Additional Warrants.

EMPLOYEES

At July 17, 2003, we employed approximately twenty-four (24) persons full and part-time, most of whom are aerospace, mechanical and electrical engineers. We expect to hire other personnel as necessary for 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.

INTELLECTUAL PROPERTY

We rely in part on 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 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 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 related to sales of hybrid technology-based products. To date, we have issued warrants to purchase a total of 100,000 shares of our common stock under the agreement.

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. In addition to historical information, the following discussion and other parts of this document contain forward-looking information that involves risks and uncertainties. Actual results could differ materially from those anticipated by such forward-looking information due to a number of factors beyond our control. (See "Forward Looking Statements" above.)

OVERVIEW

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 development of low-cost micro-satellites, nanosatellites and related subsystems, hybrid rocket propulsion as well as the associated engineering technical services primarily to government, and specifically Department of Defense, agencies. Our products and solutions are sold, mainly on a project-basis, directly to these customers and include sophisticated micro- and nanosatellites, hybrid rocket-based orbital Maneuvering and orbital Transfer Vehicles ("MTVs") as well as safe sub-orbital and orbital hybrid rocket-based propulsion systems. Although we believe there will be a commercial market for our micro-satellite and nano-satellite products and services in the long-term, the early adopters of this technology appears to be the military and our "products" are considered to be the outcome of specific projects. We are also developing commercial hybrid rocket motors 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") and subsequently changed our name to "SpaceDev." 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, our operations were expanded with the acquisition of Integrated Space Systems, Inc. ("ISS"), a California corporation founded for the purpose of providing engineering and technical services related to space-based systems. The ISS employee base, acquired upon acquisition, largely consisted of former General Dynamics personnel and enlarged our then current employee base to 20 employees. ISS was purchased for approximately $3.6 million, paid in Rule 144 restricted common shares of SpaceDev. Goodwill of approximately $3.5 million was capitalized and was to be amortized over a period of 60 months, based on the purchase price exceeding the net asset value of approximately $164,000. As a

result of a change in corporate focus, on November 15, 2001, we determined that the unamortized balance of goodwill from ISS, which was approximately $923,000, had become impaired and it was written off. While the ISS segment did provide small hybrid propulsion space systems and engineering services on separate contracts (mainly with the government), the engineering service contracts had expired and, therefore, would not be producing revenue or cash flow to support future operations. We determined that all future business, contracts, and

proposals would be sought after only in the SpaceDev name, making it a more efficient way for us to manage and track multiple contracts and work on many different business ventures at the same time within the same operating segment.

In November 1999, we won a $4.9 million turnkey mission contract by the Space Sciences Laboratory ("SSL") at University of California, Berkeley ("UCB"). We were competitively selected by UCB/SSL to design, build, integrate, test and operate, for one year, a small NASA-sponsored scientific, Earth-orbiting spacecraft called CHIPSat. CHIPSat is the first mission of NASA's low-cost University-Class Explorer ("UNEX") series. 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. In 2000, we reviewed the contract status at year-end and determined that the total estimated costs at the end of the program would exceed the likely revenue. As a result, we accrued a loss of approximately $860,000 based on the expected contract modification of $600,000, which was approved on June 15, 2001. On November 28, 2001, a second contract modification was signed with UCB, which added approximately $1.2 million to the contract as well as an increase in contract scope. This increased the total contract revenue to approximately $6.8 million and reduced the total expected loss on the contract to approximately $460,000. During 2002, an additional contract modification for approximately $400,000 was signed, which also increased the contract value and scope to the current value of the CHIPSat project of approximately $7.4 million, further reducing the total expected loss on the contract to approximately $514,000, most of which could have been recorded as research and development costs associated with the development of our ongoing satellite design and development programs. As of December 31, 2002, approximately 97% of the total contract costs were expended and the remaining loss on the balance sheet at year-end totaled approximately $11,000. The CHIPSat program generated approximately $2.1 million and $3.2 million of revenue in 2000 and 2001, respectively. Revenues for 2002 were approximately $1.7 million and are expected to be approximately $400,000 in 2003. We are currently receiving monthly payments on the contract according to a preset payment schedule detailed in the contract. The CHIPSat contract is expected to conclude in January 2004.

In April 2001, we were awarded one of four $1.0 million contracts from NASA's Jet Propulsion Laboratory in Pasadena, California. As part of a Boeing-led team, we participated in a study of the options for a potential Mars sample return mission in 2011. The contract ran from April through October 2001. Our revenue from this contract in 2002 and 2001 was approximately $7,000 and $216,000, respectively.

In September 2001, we were awarded a contract for a proprietary propulsion research program valued in excess of $1.0 million. As a part of that program, we are competing with another party to design a space propulsion system. The entire contract, which will be awarded based upon the submitted designs, is valued at approximately $2.2 million. We expect this contract to generate revenue in 2003 of approximately $240,000. Work on this project generated approximately $1.2 million in revenues during 2002. To date, we have recognized approximately $24,000 of gross margin on this contract. We reviewed the contract status in the

fourth quarter of 2002, to evaluate changes to the total estimated costs to

complete the contract due to schedule delays. Further discussion of the impacts of the contract delay is included under "Liquidity and Capital Resources - Forward Looking Statements and Risk Analysis" below.

On April 30, 2002, we were awarded Phase I of a contract to develop a Shuttle-compatible propulsion module for the Air Force Research Lab ("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 contract. In addition to the Phase I and Phase II awards, there is an option worth approximately $1 million. The option has been awarded and work will begin once certain milestones are met to the satisfaction of the AFRL project manager.

On July 9, 2003, we were awarded a Phase I contract to develop micro- and nano-satellite bus and subsystem designs. This AFRL Small Business Innovation Research (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.

On July 9, 2003, we were awarded a Phase I SBIR contract by 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 also valued at approximately $100,000, is a fixed price, milestone-based agreement, which should be completed within one year. Both SBIRs have the possibility of Phase II carry-forward 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 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 will explore 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 value is $800,000, and the total value of our microsatellite studies for MDA is over $1 million this year.

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. We will 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 study picks up where we left off from our original 1997 Near Earth Asteroid Prospector (NEAP) mission design, our 1999 Mars MicroMission design for NASA's JPL, and our work in 2001 with Boeing on possible commercial lunar orbiter missions. This contract is valued at $100,000, is a fixed price, milestone-based agreement, which should be completed by November 20, 2003.

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. 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. See "Results of Operations" below.

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, 2002 -Vs.- Year Ended December 31, 2001

During the year ended December 31, 2002, we had net sales of $3.4 million as compared to net sales of $4.1 million in 2001. Sales in 2002 were comprised of approximately $1.7 million from the CHIPSat program, approximately $1.2 million from a contract for a proprietary propulsion development program, approximately $300,000 from the completion of our outstanding State Grants, approximately $70,000 from Phase I of the AFRL project and approximately $130,000 from all other programs. In 2001, sales were comprised of approximately $3.2 million from the CHIPSat program, approximately $328,000 from a contract for a proprietary propulsion development program, approximately $228,000 from research and development performed for the Office of Space Launch ("OSL"), approximately $216,000 from the Boeing Mars Sample Return and Mars Assent Vehicle projects, and approximately $164,000 from all other programs.

For the year 2002, we had costs of sales (direct and allocated costs associated with individual contracts) of approximately $3.3 million as compared to approximately $2.4 million in 2001. This increase was primarily due to

additional project costs as a result of project delays and scope changes. The gross margin percentage for the year ended December 31, 2002 was 2% as compared to 41% for the same period in 2001. The decrease was due to additional project costs due to contract delays and an allocation of certain G&A expenses to cost of goods sold.

We experienced a decrease in operating expenses from approximately $3.2 million in 2001 to approximately $66,000 for 2002. Operating expenses include

general and administrative expenses and research and development expenses. General and administrative expenses consisted primarily of salaries for administrative personnel, fees for outside consultants, insurance, legal and accounting fees and other overhead expenses. The reduction of approximately $3.1 million in the operating expenses was due in part to the arbitration ruling reversal of the EMC stock issuance of 500,000 shares and a resulting credit of $455,000 in 2002 that was expensed in 2001. See "Legal Proceeding" above. Other issues involving the reduction in operating expenses can be attributed to a reduction of research and development costs from $198,400 in 2001 to none for the same period in 2002, a write-off of $923,000 in 2001 related to the impairment of the unamortized balance of goodwill from the ISS acquisition, the amortization expense related to goodwill for ISS of $520,000 incurred in 2001 compared to none in 2002, the expense of $150,000 for a contingent liability due to Technical & General Guarantee Company Limited expensed in 2001 compared to none in 2002, an issuance of 80,000 stock options that had a value of $67,000 for the acquisition of Explorespace.com that was expensed as advertising in 2001 compared to no equivalent expense in 2002, as well as, a deduction in salaries of approximately $190,000 from 2001 to 2002 due to changes in personnel. In addition, we began a system of more fully absorbing costs into projects, effectively shifting approximately $600,000 of expenses that were recorded as operating expenses in 2001 to cost of goods sold in 2002.

Interest expense for the periods ending December 31, 2002 and 2001 was approximately $263,000 and $303,000, respectively. We paid interest expense on certain capital leases and mortgages. In addition, we accrued interest expense related to our related party notes and convertible debentures. In 2002, we accrued a convertible debt discount related to warrants that accompanied the convertible debt issue of approximately $475,000, of which $125,000 was expensed in 2002 and the remainder will be amortized over the remaining life of the notes.

During the year ended December 31, 2002, we incurred a net loss of approximately $400,000, compared to a net loss of approximately $1.9 million for the same period in 2001. The decrease in the net loss was due to our reduction in operating expenses by approximately $3.2 million. As discussed above, the decrease was primarily attributable to non-cash expenses, including impairment of the un-amortized balance of goodwill from ISS, goodwill expense in 2001, stock issued to EMC in 2001 and then recovered by us in 2002, the note payable to T&G, the stock options issued for the acquisition of ExploreSpace.com, and research and development costs.

Three-Months Ended March 31, 2003 vs Three Months Ended March 31, 2002

During the three-months ended March 31, 2003, we had net sales of $532,840 as compared to net sales of $949,770 for the same period in 2002. Sales in 2003 were comprised of approximately $237,000 from the proprietary propulsion contract, $157,000 from the MDA project, $112,000 from the CHIPSat program, $20,000 from Phase I of the AFRL project and approximately $7,000 from all other programs. In the first quarter of 2002, sales were comprised of approximately

$481,000 from the CHIPSat program, $365,000 from the proprietary propulsion contract and $104,000 from all other programs.

For the three-months ended March 31, 2003, we had costs of sales (direct and allocated costs associated with individual contracts) of approximately $462,000, 87% of net sales, as compared to approximately $712,000, 75% of net sales, during the same period in 2002. This decrease was primarily due to an overall reduction of direct costs on current projects and to delays on additional projects. The gross margin percentage for the three-months ended March 31, 2003 declined to 13.4% as compared to 25% for the same three-month period in 2002, mainly due to continued delays and customer schedule slips on existing contracts.

We experienced an increase in operating expenses from approximately $212,000, 22% of net sales, in the three-months ended March 31, 2002 to approximately $435,000, 82% of net sales, for the three-months ended March 31, 2003. Operating expenses include general and administrative expenses (G&A), and marketing and sales expenses. Marketing and sales expenses increased from approximately $26,000, 3% of net sales, to approximately $65,000, 12% of net sales, during the same period in 2002, due to our decision to expand our marketing department, including the addition of a Vice President of Marketing and Product Development. G&A expenses consisted primarily of salaries for administrative personnel, fees for outside consultants, insurance, legal and accounting fees and other overhead expenses. The increase of approximately $184,000 in G&A was due certain new expenses including rent of $53,000 and amortization expense of the capitalized software costs of $34,500, which did not begin until the second quarter of 2002, and in part to an increase in G&A personnel, including our vice president of operations and our chief financial officer and increases in general overhead expenses of approximately $18,000 and $78,500 in other expenses for the three-months ended March 31, 2003.

Interest expense for the three-months ended March 31, 2003 and 2002 was approximately $20,000, 4% of net sales, and $55,000, 6% of net sales, respectively. The decrease was due to the building sale on January 31, 2003, which 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 and convertible debentures. In the three-months ended March 31, 2003 and 2002, the accrued interest on our related party note was $9,866 and $12,066, respectively. We also accrued approximately $2,400 of interest on our convertible notes for the three-months ended March 31, 2003. In conjunction with our convertible notes, there is an existing convertible debt discount related to warrants that accompanied the convertible debt issue in 2002 of approximately $475,000, of which approximately $100,000 was expensed during the three-months ended March 31, 2003. The remainder will be amortized over the remaining life of the notes. We recognized approximately $20,000 of the deferred gain on the sale of the building during the first quarter of 2003 and we will continue to amortize the remaining deferred gain of $1,153,175 into income over the remainder of the lease.

During the three-months ended March 31, 2003, we incurred a net loss of approximately $533,000, 95% of net sales, compared to a net loss of approximately $29,000, 3% or net sales, for the same three-months ended in 2002. The increase in the net loss was due to our reduction in revenues and to an increase in operating expenses, as discussed above.

LIQUIDITY AND CAPITAL RESOURCES

Our auditors have expressed a formal auditors' opinion that our December 31, 2002 financial position raises substantial doubt about our ability to continue as a going concern. The opinion is based on net losses incurred by us for the years ended December 31, 2002 and 2001 of approximately $400,000 and $1.9 million, respectively, and working capital deficits of approximately $200,000 and $1.0 million, respectively, for those years. Although there was a significant reduction in the working capital deficit, items remain that raise substantial doubt about our ability to continue as a going concern.

On January 31, 2003, we closed escrow on the sale of our facility in Poway, California and entered into a ten-year lease for the same facility. The selling price of the facility was $3.2 million. The total debt repayment from the transaction was approximately $2.4 million. The approximate net proceeds to us for working capital purposes was approximately $636,000. However due to continuing delays and schedule slips with our commercial propulsion project and further delays in obtaining new contract business, we remain in a cash crisis.

From October 14, 2002 through November 14, 2002, we raised $475,000 from certain of our directors and officers by issuing 2.03% convertible debentures. The convertible debentures entitle the holder to convert the principal and unpaid accrued interest into our common stock when the note matures. The original maturity on the notes was six (6) months from issue date and were subsequently extended to twelve (12) months from issue date on March 19, 2003. The convertible debentures are exercisable into a number of our common shares at a conversion price that equals the 20-day average asking price less 10%, which was established when the note was issued, or the initial conversion price. Concurrent with the issuance of the convertible debentures, we issued to the subscribers, warrants to purchase 1,229,705 shares of our common stock. These warrants are exercisable for three (3) years from the date of issuance at the initial exercise price which equals to the 20-day average asking price less 10% which was established when the note was issued, or the initial conversion price. There can be no assurance that additional funds will be raised and if raised, will be under the same or more favorable terms than the convertible debentures.

We have sustained ourselves over the last few years with a mixture of government and commercial contracts. In particular, we anticipated and received an award for AFRL Phase II on March 28, 2003. AFRL Phase II is a cost-plus contract, which will require us to incur certain costs in advance of regular contract reimbursements from AFRL. Although we will need a certain amount of cash to fund advance payments on the contract, we will be entitled, as a small business concern, to recover our costs on a weekly basis. In addition, we anticipated and received a purchase order from the Missile Defense Agency (MDA) to explore the use of micro-satellites in national missile defense. To be explored in this study will be fast response microsat launch and commissioning; small, low-power passive sensors; 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 purchase order value is $800,000. It is a cost plus agreement and is anticipated to be completed in the first quarter of 2004.

We can continue to grow and execute certain parts of our strategy without additional equity funding by identifying, bidding and winning new commercial and government funded programs. We expect to obtain new commercial and government contracts; however, depending on the timing of those contracts, we may need to seek additional and possibly immediate financing through a combination of public and private debt or equity placements, commercial project financing and government programs to fund future operations and commitments. We were

successful in obtaining a revolving credit facility from Laurus Master Fund, as described herein; however, there is no assurance that new contracts or additional debt or equity financing needed to fund operations will be available or obtained in sufficient amounts necessary to meet our needs. 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.

Cash Position For Year Ended December 31, 2002 -Vs.- Year Ended December 31, 2001

Net decrease in cash during the year ending December 31, 2002 was approximately $184,000, compared to a net decrease of $48,000 for the same period in 2001. Net cash used in operating activities totaled approximately $707,000 for the year ending December 31, 2002, a decrease of approximately $775,000 as compared to approximately $68,000 provided by operating activities during the same period in 2001. This is attributable primarily to the increased costs on the CHIPSat project as well as the contract for a proprietary propulsion research program, both of which, at December 31, 2002, had costs that exceeded their billings for the ongoing work toward completion of these programs.

Net cash provided by investing activities totaled approximately $48,000 for the year ended December 31, 2002, compared to approximately $43,000 of net cash used in investing activities during the same period in 2001. The increase in cash used of $91,000 is attributable to a reduction in the purchase of fixed assets and an advance payment made toward the purchase of our facility in January 2003. Net cash provided by financing activities totaled approximately $475,000 for the year ended December 31, 2002, which showed an increase of $549,000 from the approximately $74,000 used in financing activities during the same period in 2001. This improvement is primarily attributable to generating more cash from sales of common stock and issuance of convertible debt in 2002 of $550,000 versus $120,000 in 2001.

At December 31, 2002, our cash, which includes cash reserves and cash available for investment, was approximately $27,000 as compared to approximately $212,000 at December 31, 2001, a decrease of approximately $184,000. At December 31, 2002, our working capital ratio improved to 0.94 compared to 0.34 at December 31, 2001.

As of December 31, 2002, our backlog of funded and non-funded business was approximately $4.0 million, as opposed to approximately $3.4 million as of fiscal year end 2001. During 2002, we won AFRL Phase I, negotiated increases of approximately $500,000 to the CHIPSat program and began a private commercial propulsion project.

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 approximately $1.4 million consisted primarily of the income tax benefits from net operating loss carryforwards, amortization of goodwill and research and development credit carryforwards. 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 decreased approximately $600,000 during 2001, from $2.0 million at December 31, 2001 to $1.4 million at December 31, 2002. Please refer to our consolidated financial statements, which are a part of this prospectus for further

information regarding our liquidity and capital resources.

Cash Position for Three-Months Ended March 31, 2003 vs. Three-Months Ended March 31, 2002

Net increase in cash during the three-months ended March 31, 2003 was approximately $183,000, compared to a net increase of $99,000 for the same three-months in 2002. Net cash used in operating activities totaled approximately ($731,000) for the three-months ended March 31, 2003, a decrease of approximately $837,000 as compared to approximately $106,000 provided by operating activities during the same three-months in 2002. This is attributable, in part, to the increased costs on the CHIPSat project as well as the proprietary propulsion project, both of which, at March 31, 2003, had costs that exceeded their billings for the ongoing work toward completion of these programs of approximately $254,000. The increase can also be contributed to the overall increase in our G&A expenses, the reduction of revenues, and the increase in accounts payable for the three-months ended March 31, 2003 compared to those positions during the same period in 2002.

Net cash provided by investing activities totaled approximately $3,147,000 for the three-months ended March 31, 2003, compared to no cash used in or provided by investing activities during the same period in 2002. The increase in cash is attributable to the sale of the building on January 31, 2003.

Net cash used in financing activities totaled approximately $2,233,000 for the three-months ended March 31, 2003, which showed an decrease of $2,226,000 from the approximately $7,000 used in financing activities during the same three-month period 2002. This is primarily attributable to paying off notes payable associated with the building sale.

At March 31, 2003, our cash, which includes cash reserves and cash available for investment, was approximately $211,000 as compared to approximately $310,000 at March 31, 2002, a decrease of approximately $99,000. At March 31, 2003, our working capital ratio improved to 0.69 compared to 0.25 at March 31, 2002.

As of March 31, 2003, our backlog of funded and non-funded business was approximately $3.2 million, as opposed to approximately $2.5 million as of March 31, 2002. During the three-months ended March 31, 2003, we won AFRL Phase II worth approximately $1.4 million, negotiated increases of approximately $1.0 million to the AFRL Phase II Contract as a deferred option still open, continued the proprietary propulsion project, and were completing significant milestones on our CHIPSat and MDA projects.

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 approximately $1.1 million, consisted primarily of the income tax benefits from net operating loss carryforwards, amortization of goodwill and research and development credit carryforwards. The federal and state tax loss carry forwards will expire through 2022 unless previously utilized. The State of California has suspended the utilization of net operating losses for 2003. 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 decreased approximately $300,000 during quarter ended March 31, 2003, from $1.4 million at December 31, 2002 to $1.1 million at March 31, 2003. Please refer to our consolidated financial statements, which are a part of this prospectus for further information

regarding our liquidity and capital resources.

CRITICAL ACCOUNTING STANDARDS

Our revenues are derived primarily from fixed price contracts and are recognized using the percentage-of-completion method of contract accounting based on the ratio of total costs incurred to total estimated costs. Losses on contracts are recognized when they become known and reasonably estimable (see Notes to the Consolidated Financial Statements). Actual results of contracts may differ from management's estimates and such differences could be material to the consolidated financial statements. Professional fees are billed to customers on a time and materials basis, a fixed price basis or a per-transaction basis. Time and materials revenues are recognized as services are performed. Billings in excess of costs incurred and estimated earnings represent the excess of amounts billed in accordance with the contractual billing terms. Deferred revenue represents amounts collected from customers for services to be provided at a future date.

In October 1995, the FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation." We adopted SFAS 123 in 1997. We have elected to measure compensation expense for our stock-based employee compensation plans using the intrinsic value method prescribed by APB Opinion 25, "Accounting for Stock Issued to Employees" and have provided pro forma disclosures as if the fair value based method prescribed SFAS 123 has been utilized. See Notes to the Consolidated Financial Statements. We have valued our stock, stock options and warrants issued to non-employees at fair value in accordance with the accounting prescribed in SFAS No. 123, which states that all transactions in which goods or services are received for the issuance of equity instruments shall be accounted for based on the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable.

Fixed assets are depreciated over their estimated useful lives of three-to-five years using the straight-line method of accounting in accordance with Statement of Financial Accounting Standards No. 144. Goodwill and other intangible assets were created upon the acquisition of our subsidiaries. Intangible assets are amortized over their assets' estimated future useful lives on a straight-line basis over three to five years. Goodwill and other intangibles are periodically reviewed for impairment based on an assessment of future operations to ensure they are appropriately valued in accordance with

Statement of Financial Accounting Standards No. 142. Effective November 2001, there will be no more amortization of goodwill (see Notes to the Consolidated Financial Statements).

RECENT ACCOUNTING PRONOUNCEMENTS

In November 2002 the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 elaborates on previously existing disclosure requirements for most guarantees. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under the guarantee and must disclose that information in its financial statements. The provisions related to recognizing a liability at inception of the guarantee for the fair value of the guarantor's obligations does not apply to product warranties or to guarantees accounted for as derivatives. FIN No. 45 also requires expanded disclosures regarding product warranty expense. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or

modified after December 31, 2002. The adoption of this Statement is not expected to have a material effect on the consolidated financial statements.

In January 2003 the FASB issued FASB Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." This interpretation provides guidance on: 1) the identification of entities for which control is achieved through means other than through voting rights, known as "variable interest entities" (VIEs); and 2) which business enterprise is the primary beneficiary and when it should consolidate the VIE. This new model for consolidation applies to entities: 1) where the equity investors (if any) do not have a controlling financial interest; or 2) whose equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, this interpretation requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. This interpretation is effective for all new VIEs created or acquired after January 31, 2003. For VIEs created or acquired prior to February 1, 2003, the provisions of the interpretation must be applied no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. Certain disclosures are effective immediately. The adoption of this Statement is not expected to have a material effect on the consolidated financial statements.

In April 2003 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 requires that contracts with comparable characteristics be accounted for similarly. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of this Statement is not expected to have a material effect on the consolidated financial statements.

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In May 2003 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. For nonpublic entities, mandatorily redeemable financial instruments are subject to the provisions of SFAS No. 150 for the first fiscal period beginning after December 15, 2003. The adoption of this Statement is not expected to have a material effect on the consolidated financial statements.

FORWARD-LOOKING STATEMENTS AND RISK ANALYSIS

During the first half of 2003, we submitted five bids for government programs, worked with the US Congress to identify directed funding for our programs and are actively working to win several commercial programs. We believe that we will win some of these programs, which would enable us to continue to grow, employ more talented engineers, become profitable in the next

year or two and broaden our business base, although there can be no assurance that these contracts will be awarded to us, and if awarded to us, would enable us to become profitable.

To date, we have maintained a mix of government and commercial business. In 2001, we had about 80% government or government-related work. In 2002, we had about 60% government and government related work. In 2003, we expect the ratio to be about 80% government or government-related work. Most of the current government contracts are cost plus agreements. The combination of our revolving credit facility with Laurus and these cost plus contracts will enable us to fund the hiring needed to "staff-up" these new projects. We will continue to do both government and commercial business and anticipate the mix of government revenues to continue to be above 60% for the next several years as we focus on military applications for our products and technologies and continue to see the government sector embrace projects demonstrating the capabilities of our products. We intend to increase our government and commercial marketing efforts for both of our product lines. Currently, we are focusing on the domestic U.S. government (military) market, which we believe is only about one-half of the global government market for our products and services. Although we are interested in exploring international revenue and contract opportunities, we are restricted by export control regulations, e.g., International Traffic in Arms Regulations ("ITAR"), which may limit our ability to develop market opportunities outside the United States.

While we do not expect a reduction of government sales, a majority of our government work is contract and project related. These customers continue to be the early adopters of our products and technologies and the outcome of the projects are often our product(s). We are beginning to develop commercial products; however, the commercial market for our products, particularly for micro- and nano-satellites and applications of our propulsion technology, may be several years away. We anticipate winning contracts in both the micro-satellite

and propulsion market segments, although there can be no assurance that the contracts will be awarded to us. If they are not awarded to us, based on current trends and proposals, we believe that we can offset fluctuations in one market segment with contracts from the other; however, our inability to win business in both markets would have a negative effect on our business operations and financial condition.

We are forecasting a modest decline in sales for 2003, with sales beginning to grow again in 2004. At this time, about 25% of the forecasted sales for 2004 are under contract or near to contract award, but there is no guarantee that we will win enough new business to achieve our targeted growth projection or to achieve a positive cash flow position. We do not believe that significant capital expenditures will be required to achieve this modest increase in sales.

As it relates to the CHIPSat program, we will receive total fixed compensation on the CHIPSat project in an amount of approximately $7.4 million, of which about $3.1 million was generated in 2001, and $1.2 million was generated in 2002. The contract calls for payments of approximately $450,000 in 2003. As outlined above, we reviewed the contract again in late 2002 and the total loss was reduced from $463,000 to approximately $432,000. As the project is completed, the loss is reduced as costs become realized. At this time, we do not expect any additional losses from or increases to the contract. The launch of CHIPSat occurred in January 2003.

We expect payments of about $240,000 in 2003 from a private commercial propulsion contract. This effort could lead to follow-on contracts from the same customer later this year, but at this time we cannot assess the probability

of winning the contract or the value of the contract.

Our broad, overall, higher growth business strategy, requires significant development and capital expenditures. We will incur a substantial portion of these expenditures before we generate significantly higher sales. Combined with operating expenses, these capital expenditures will result in a negative cash flow until we can establish an adequate revenue-generating customer base. We expect losses through the first part of 2003 and expect to begin generating net positive cash flow from operations sufficient to fund both operations and capital expenditures toward the end of 2003. There is no assurance, however, that we will achieve or sustain any positive cash flow or profitability thereafter.

During the years ended December 31, 2002 and 2001, we raised approximately $145,000 through private sales of stock and approximately $475,000 from our convertible debt offering. To execute our strategy of small, capable, low-cost micro- and nano-satellites, hybrid propulsion products and new commercial revenue sources, we require significant funding and/or the win of both significant government and commercial programs. We believe investor or customer funding of $1 to $5 million will be required, which could come from a combination of private and/or public equity placements or government and commercial customers. At this time, we do not have any ongoing private or public equity offerings.

We need to raise additional capital. The amount of capital we need to raise is dependent upon many factors. For example, the need for additional

capital will be greater if (i) we do not enter into agreements with other customers on the terms we anticipate; (ii) our net operating deficit increases because we incur significant unanticipated expenses; or (iii) we incur additional costs from modifying our micro-satellite products or our proposed hybrid-related systems to meet changed or unanticipated market, regulatory, or technical requirements. If these or other events occur, there is no assurance that we could raise additional capital on favorable terms, on a timely basis or at all. If additional capital is not raised, it could have a significant negative effect on our business operations and financial condition, possibly causing us to take immediate cost reduction or other actions.

Our ability to execute a public offering or otherwise obtain funds is subject to numerous factors beyond our control, including, without limitation, a receptive securities market and appropriate governmental clearances. No assurances can be given that we will be profitable, or that any additional public offering will occur, that we will be successful in obtaining additional funds from any source or be successful in implementing an acceptable exit strategy on behalf of our investors. Moreover, additional funds, if obtainable at all, may not be available on terms acceptable to us when such funds are needed or may be on terms which are significantly adverse to our current shareholders. The unavailability of funds when needed would have a material adverse effect on us.

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. Recently, 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 is being 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, 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.

DESCRIPTION OF PROPERTY

Subsequent to year-end, we entered into a 25,000 square foot lease for our facility in Poway, California that includes a small Spacecraft Assembly and Test facility ("SAT") with an 1,800 square foot Class 100,000 clean room, avionics development lab, machine shop, mechanical assembly lab, and mission operations center. Key uses of the Poway facility are program and project conferences and meetings, engineering design, engineering analysis, spacecraft assembly, avionics labs and software labs and media outreach. We also have a Mission Control Center in the Poway building, which is currently being used to monitor the CHIPSat mission. Our facility allows for efficient design, assembly and test of our products, thereby providing us a cost effective means to produce quality, low cost products.

We purchased our headquarter facility, which houses our engineering, manufacturing and administration, in the Poway Industrial Park complex in December 1998. We subsequently sold our facility on January 31, 2003, wherein we entered into a ten (10) year leaseback of the facility. [See Notes to our audited condensed consolidated financial statements for the fiscal year ended December 31, 2002 for additional information.] The selling price of the facility was $3.2 million. The total debt repayment from the transaction was approximately $2,407,000. The approximate net proceeds to us for working capital purposes was $636,000. Mr. Benson provided a guarantee for the leaseback.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

James W. Benson, our Chief Executive Officer and Chairman of the Board of Directors, and Susan Benson, our former Corporate Secretary, are husband and wife. Mr. Benson has personally guaranteed the building lease on our facility.

One of our independent directors, Robert S. Walker, is a principal of Wexler & Walker Public Policy Associates, a Washington-based, full-service government relations firm founded in 1981. Wexler & Walker principals have served in Congress, in the White House and federal agencies, as congressional staff, in state and local governments and in political campaigns. Wexler & Walker is a leader on the technology issues of the twenty-first century. During 2002 and 2001, we incurred consulting fees with Hill and Knowlton, Inc., an affiliate of Wexler & Walker, in an aggregate amount of approximately $56,000 and $36,000.

In September and October 2002, certain of our officers provided personal interest-free short-term loans to support our working capital needs. The officer loans were paid with the proceeds from imminently pending contract payments and the proceeds of the convertible note program sales.

From October 14, 2002 through November 14, 2002, we sold an aggregate of $475,000 of 2.03% convertible debentures to three of our directors and officers. Mr. Benson purchased $375,000 of Series A Subordinated Convertible Notes and Mr. Shaffer purchased $50,000. The total funding was completed on November 14, 2002. The convertible debentures entitle the holder to convert the principal and unpaid accrued interest into our common stock when the note matures. The notes

originally were set to mature six (6) months from issue date and were subsequently extended to twelve (12) months from issue date on March 19, 2003, unless paid, extended or re-negotiated, the convertible debentures are exercisable into a number of our common shares at a conversion price that equals the 20-day average asking price less 10%, which was established when the note was issued, or the initial conversion price. Concurrent with the issuance of the convertible debentures, we issued to the subscribers, warrants to purchase up to 1,229,705 shares of our common stock. These warrants are exercisable for three (3) years from the date of issuance at the initial exercise price, which equals to the 20-day average asking price less 10% which was established when the note was issued, or the initial conversion price. Upon issuance, the warrants were valued using the Black-Scholes pricing model based on the expected fair value at issuance and the estimated fair value was recorded as debt discount. See Note 8(c) to our Consolidated Financial Statements for discussion of the terms of the

warrants. The debt discount is being amortized as additional interest expense over the term of the convertible debentures. (See "Management's Discussion And Analysis Of Financial Condition And Results Of Operations.")

MARKET FOR COMMON EQUITY & RELATED STOCKHOLDER MATTERS

MARKET INFORMATION

Our common stock has been traded on the Over-the-Counter Bulletin Board ("OTCBB") since October 1997 under the symbol "SPDV." The following table sets forth the trading history of our common stock on the OTCBB for each quarter as reported by Dow Jones Interactive. The quotations reflect inter-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions.

Quarter Ending	Quarterly High	Quarterly Low
3/31/2001	1.03	0.63
6/30/2001	0.97	0.45
9/30/2001	1.01	0.69
12/31/2001	0.86	0.35
3/31/2002	0.65	0.48
6/30/2002	0.64	0.43
9/30/2002	0.52	0.3
12/31/2002	0.5	0.29
3/31/2003	0.55	0.36
6/30/2003	0.75	0.33

7/17/2003	*	0.85	0.55

*Reflects partial period.

HOLDERS

As of June 30, 2003, there were approximately 200 holders of record of our common stock. We estimate the total number of beneficial owners of our common stock to be in excess of 2,500 holders. We believe that the number of beneficial

owners is substantially greater than the number of record holders because a significant portion of our outstanding common stock is held in broker "street names" for the benefit of individual investors.

DIVIDENDS

We have never paid a cash dividend on our Common Stock. Payment of dividends is at the discretion of the Board of Directors. The Board of Directors plans to retain earnings, if any, for operations and does not intend to pay dividends in the foreseeable future.

DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS & CONTROL PERSONS

Our management and directors' business activities are under the control of our Board of Directors. Our Chief Executive Officer, James W. Benson, and our Chief Financial Officer, Richard B. Slansky, manage our daily operations. Our Board currently consists of eight directors. General Howell M. Estes, III (USAF Retired), and Retired Congressman Robert S. Walker were added to the Board of Directors in 2001. Stuart Schaffer and Scott McClendon were added to the Board of Directors in 2002. J. Mark Grosvenor joined our Board of Directors in 2003. Below are our executive officers and directors.

NAME	POSITION HELD
James W. Benson 13855 Stowe Drive Poway, California 92064	Chief Executive Officer, Director, Chairman of the Board
Richard B. Slansky 13855 Stowe Drive Poway, CA 92064	Corporate Secretary, Chief Financial Officer
Stuart Schaffer 13855 Stowe Drive Poway, California 92064	Director Vice President, Product Development & Marketing
J. Mark Grosvenor* 13855 Stowe Drive Poway, CA 92064	Director
Wesley T. Huntress* 13855 Stowe Drive Poway, California 92064	Director
Curt Dean Blake*	Director

13855 Stowe Drive
Poway, California 92064

General Howell M. Estes, III (USAF Retired)* Director
13855 Stowe Drive
Poway, California 92064

Robert S. Walker* Director
13855 Stowe Drive
Poway, California 92064

Scott McClendon * Director
13855 Stowe Drive
Poway, California 92064

* Denotes Independent Director

The following is a summary of the business experience of our officers and directors as well as other key employees.

James W. Benson (58) - Chief Executive Officer and Chairman of the Board of Directors

Mr. Benson is our founder, Chairman and Chief Executive Officer. Mr. Benson served as our President until he resigned from that position on February 4, 2000. Mr. Benson is also our Chairman of the Board, a position he has held since October 1997. In 1984, Mr. Benson founded Compusearch Software Systems in McLean, Virginia, a company based on use of personal computers to create full text indexes of massive government procurement regulations and to provide fast full text searches for any word or phrase; the first instance of large scale, commercial implementation of PC-based full text searching. Mr. Benson sold Compusearch and started SpaceDev LLC, which was acquired by us in October 1997. Mr. Benson holds a Bachelor of Science degree in Geology from the University of Missouri. He founded the non-profit Space Development Institute and introduced the $5,000 Benson Prize for Amateur Discovery of Near Earth Objects. He is also Vice-Chairman and private sector representative on NASA's national Space Grant Review Panel and a member of the American Society of Civil Engineers subcommittee on Near Earth Object Impact Prevention and Mitigation.

Stuart E. Schaffer (44) - Vice President of Product Development and Marketing

Mr. Schaffer has served as our Vice President of Product Development and Marketing since May 20, 2002 and will be resigning as an officer on August 8, 2003. Mr. Schaffer will remain on our Board. From 1998 to 2001, Mr. Schaffer acted as Vice President of Marketing for Infocus Corporation, a fully reporting company, where he managed all aspects of the marketing mix for market-share leading digital projection business throughout the Americas region. In that position, Mr. Schaffer revitalized the Proxima brand, managed a multi-million dollar annual advertising, communications and program budget, directed multiple outside and in-house agencies, led product marketing teams in defining and delivering both mobile and conference room digital projector product lines, developed channel strategies and programs for both value-added and volume channels, served as primary press spokesperson for the company, established a market intelligence structure focused on developing customer and industry knowledge and spearheaded merger teams to ensure the smooth transition of the merger between the Infocus and Proxima marketing organizations. Prior to his employment by Infocus Corporation, Mr. Schaffer worked for the Hewlett-Packard Company from 1985 to 1998, where he held various positions in Business Development, Marketing and Business Planning. Mr. Schaffer worked with the

Leukemia & Lymphoma Society, on a volunteer basis, as an Assistant Coach and Mentor from 2000 through the date of employment with us. In that capacity, he was responsible for ensuring that participants in the Society's Team-in-Training Program reached their goal to run a marathon, while mentoring them in fundraising for research and aid for patients suffering from Leukemia and other blood-related cancers. Mr. Schaffer has an MBA from Harvard University (1985) and a BS degree in physics from Harvey Mudd College (1981).

Richard B. Slansky (46) - Chief Financial Officer

Mr. Slansky is the Chief Financial Officer and Corporate Secretary and joined us on February 10, 2003. Mr. Slansky served as interim Chief Executive Officer and Chief Financial Officer of Quick Strike Resources, Inc., an IT training, services and consulting firm, from July 2002 to February 2003. Previously, Mr. Slansky served as Chief Financial Officer, Vice President of Finance, Administration and Operations and Corporate Secretary for Path 1 Network Technologies, Inc., a company focused on merging broadcast and cable quality video transport with IP networks from May 2000 to July 2002. Before his tenure at Path 1, Mr. Slansky served as President, Chief Financial Officer and member of the Board of Directors of Nautronix, Inc., a marine electronics/engineering services company, from January 1999 to May 2000. Prior to Nautronix, Mr. Slansky served as Chief Financial Officer of Alexis Corporation, an international pharmaceutical research products technology company, from August 1995 to January 1999. He also served as President and Chief Financial Officer of C-N Biosciences, formerly Calbiochem, from July 1989 to July 1995. Mr. Slansky is currently serving on the Board of Directors of two privately held high technology companies and one closely held, private real estate company. Mr. Slansky earned a bachelor's degree in economics and science from the University of Pennsylvania's Wharton School of Business and a master's degree in business administration in finance and accounting from the University of Arizona.

Scott McClendon (64) - Director

Scott McClendon was appointed to the Board of Directors as an independent director on July 19, 2002. McClendon currently sits on the Board of Directors for Overland Storage, Inc., where he acts as chairman of the Board. He became the chairman after serving as President and Chief Executive Officer from October 1991 to March 2001. Prior to joining Overland Storage, Inc., Mr. McClendon was employed by Hewlett-Packard Company for over 32 years in various positions of engineering, manufacturing, sales and marketing. Mr. McClendon received a Bachelor of Science degree in electrical engineering in June 1960, and a Master of Science degree in electrical engineering in June 1962 from Stanford University School of Engineering.

J. Mark Grosvenor (55) - Director

J. Mark Grosvenor was appointed to the Board of Directors as an independent director at our Board Meeting on March 19, 2003. Mr. Grosvenor is currently Chief Executive Officer of Grosvenor Industries, originally established in San Diego in 1979. Grosvenor Industries was involved in the purchase and sale of the historic El Cortez Hotel in addition to owning three other city blocks of property in downtown San Diego. Grosvenor Industries also owns and operates Grosvenor Square Shopping Center. Since 1979, Mr. Grosvenor has built three hotels and has founded or become involved with many other national businesses. In 1984, he started Medallion Foods, Inc. in Newport, Arkansas, a snack food manufacturing company supplying Wal-Mart, Sam's Club and Costco as well as other companies. In 1989, Grosvenor formed GHG Hospitality, Inc., which owns and operates eleven hospitality projects including motels, hotels, resorts, and

marinas across the United States. Prior to founding Grosvenor Industries and its combination of businesses, Grosvenor worked for more than three years as a stockbroker and financial planner. In 1973 he founded Jaymark Financial, a real

estate company with offices in San Diego, Tokyo and Osaka, Japan. Mr. Grosvenor graduated from San Diego State University with a bachelor's degree in business and finance. Mr. Grosvenor has been very active in the community as a member of San Diego Sheriff's Association Honorary Deputy, Young Presidents Organization: California and Colorado Chapters, the President's Council at San Diego State University, the Lincoln Club, the San Diego Rotary, the University Club and the San Diego Yacht Club. He serves as a Director of the Grosvenor Foundation, a private family foundation which funds other charities.

Wesley T. Huntress (61) - Director

Wesley T. Huntress was elected to our Board of Directors as an independent director at our annual shareholder meeting held June 30, 1999. Dr. Huntress is currently Director of the Geophysical Laboratory at the Carnegie Institution of Washington in Washington, DC, where he leads an interdisciplinary group of scientists in the fields of high-pressure science, astrobiology, petrology and biogeochemistry. Prior to his appointment at Carnegie, Dr. Huntress served the Nation's space program as the Associate Administrator for Space Science at NASA from October 1993 through September 1998 where he was responsible for NASA's programs in astrophysics, planetary exploration, and space physics. During his tenure, NASA space science produced numerous major discoveries, and greatly increased the launch rate of missions. These discoveries include the discovery of possible ancient microbial life in a Mars meteorite; a possible subsurface ocean on Jupiter's moon Europa; the finding that gamma ray bursts originate at vast distances from the Milky Way and are extraordinarily powerful; discovery of massive rivers of plasma inside the Sun; and a wealth of announcements and images from the Hubble Space Telescope, which have revolutionized astronomy as well as increased public interest in the cosmos. Dr. Huntress also served as a Director of NASA's Solar System Exploration Division from 1990 to 1993, and as special assistant to NASA's Director of the Earth Science and Applications from 1988 to 1990. Dr. Huntress came to NASA Headquarters from Caltech's Jet Propulsion Laboratory ("JPL"). Dr. Huntress joined JPL as a National Research Council resident associate after receiving is B.S. in Chemistry from Brown University in 1964 and his Ph.D. in Chemical Physics from Stanford in 1968. He became a permanent research scientist at JPL in 1969. He and his JPL team gained an international reputation for their pioneering studies of chemical evolution in interstellar clouds, comets and planetary atmospheres. At JPL Dr. Huntress served as co-investigator for the ion mass spectrometer experiment in the Giotto Halley's Comet mission, and as an interdisciplinary scientist for the Upper Atmosphere Research Satellite and Cassini missions. He also assumed a number of line and research program management assignments while at JPL, and spent a year as a visiting professor in the Department of Planetary Science and Geophysics at Caltech.

Curt Dean Blake (45) - Director

Curt Dean Blake was appointed to the Board of Directors as an independent director on September 5, 2000. Mr. Blake acted as the Chief Operating Officer of the Starwave Corporation from 1993 until 1999, where he managed business development, finance, legal and business affairs, and operations for the world's most successful collection of content sites on the Internet. During that time, he developed business strategies, financial models, and structured and negotiated venture agreements for Starwave's flagship site, ESPN Sportszone, at

that time the highest traffic destination site on the Internet. He also developed and negotiated venture agreements with the NBA, NFL, Outside Magazine and NASCAR to create sites around these brands. Mr. Blake negotiated sale of controlling interest in Starwave Corporation to Disney/ABC. Prior to Starwave, Mr. Blake worked at Corbis from 1992 to 1993, where he led the acquisitions and licensing effort to fulfill Bill Gates' vision of creating the largest taxonomic database of digital images in the world. Mr. Blake acted as General Counsel to Aldus Corporation from 1989 to 1992, where he was responsible for all legal matters of the $125 million public corporation and its subsidiaries. Prior to that, Mr. Blake was an attorney at Shidler, McBroom, Gates and Lucas, during which time he was assigned as onsite counsel to the Microsoft Corporation, where he was primarily responsible for the domestic OEM/Product Support and Systems Software divisions. Mr. Blake has an MBA and JD from the University of Washington.

General Howell M. Estes, III (USAF Retired) (61) - Director

General Howell M. Estes, III (USAF Retired), was appointed to the Board of Directors as an independent director on April 2, 2001. General Estes retired from the United States Air Force in 1998 after serving for 33 years. At that time he was the Commander-in-Chief of the North American Aerospace Defense Command ("CINCNORAD") and the United States Space Command ("CINCSPACE"), and the Commander of the Air Force Space Command ("COMAFSPC") headquartered at Peterson AFB, Colorado. In addition to a Bachelor of Science Degree from the Air Force Academy, he holds a Master of Arts Degree in Public Administration from Auburn University and is a graduate of the Program for Senior Managers in Government at Harvard's JFK School of Government. Gen. Howell Estes is the President of Howell Estes & Associates, Inc., a wholly owned consulting firm to CEOs, Presidents and General Managers of aerospace and telecommunications companies worldwide. He serves as Vice Chairman of the Board of Trustees at The Aerospace Corporation. He served as a consultant to the Defense Science Board Task Force on SPACE SUPERIORITY and more recently as a commissioner on the U.S. Congressional Commission to Assess United States National Security Space Management and Organization (the "Rumsfeld Commission").

Robert S. Walker (60) - Director

Robert S. Walker was appointed to the Board of Directors as an independent director on April 2, 2001. Mr. Walker has acted as Chairman of Wexler & Walker Public Policy Associates in Washington, D.C. since January 1997. As a former Congressman (1977-1997), Chairman of the House Science Committee, Vice Chairman of the Budget Committee, and a long-time member of the House Republican leadership, Walker became a leader in advancing the nation's space program, especially the arena of commercial space, for which he was the first sitting House Member to be awarded NASA's highest honor, the Distinguished Service Medal. Bob Walker is a frequent speaker at conferences and forums. His main issues include the breadth and scope of space regulation today, and how deregulation could unleash the telecommunications, space tourism, broadcast and Internet industries. Mr. Walker currently sits on the board of directors of Aerospace Corporation, a position he has held since March 1997. Wexler & Walker is a Washington-based, full-service government relations firm founded in 1981. Wexler & Walker principals have served in Congress, in the White House and

federal agencies, as congressional staff, in state and local governments and in political campaigns. Wexler & Walker is a leader on the technology issues of the twenty-first century. During 2002 and 2001, we incurred consulting fees with Hill and Knowlton, Inc., an affiliate of Wexler & Walker, in an aggregate amount

of approximately $56,000 and $36,000, respectively.

SIGNIFICANT EMPLOYEES

Jeff Janicik, Age 35, is our director of engineering and flight systems and was primarily responsible for managing the success of the CHIPSat project. He is responsible for managing the engineering effort at SpaceDev and also oversees all flight system / component marketing and research activity. Mr. Janicik has over 13 years experience in program management, engineering and instruction in aerospace. Before coming to us in January 2000, Mr. Janicik spent ten years as a project manager, engineer and instructor in the field of aerospace working for the United States Air Force in designing low-cost, streamlined approaches for the X-40A and X-37 program at Air Force SMC/TE, and set the precedent for future space vehicle demos with extensive research of safety, technical and operational issues. Mr. Janicik has an Aerospace Engineering degree from the University of Notre Dame and a Master's Degree in Mechanical Engineering from the University of California, Davis, which he received while serving as an active duty officer in the United States Air Force.

EXECUTIVE COMPENSATION

REMUNERATION PAID TO EXECUTIVES

The following table sets forth the remuneration to our executive officers for the past three fiscal years:

SUMMARY COMPENSATION TABLE

		Annual Compensation			Long Term Compensation	
					Awards	
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compen-sation ($)	Restricted Stock Award(s) ($)	Securities Underlying Options/ SARs(#)
James W.	2000	42,946	--	--	--	2,500,000
Benson, CEO	2001	147,923	--	--	--	10,000
(2)	2002	141,325	--	--	--	--
Charles H.	2000	77,770	--	--	--	750,000
Lloyd, COO	2001	200,000	--	--	--	10,000
&CFO	2002	118,565	--	--	--	--

(1) Mr. Benson was awarded 2,500,000 options in 1997 and those options were modified in 2000. Messrs. Benson and Lloyd were awarded 10,000 options each as a part of an annual award of options to our employees. Mr. Lloyd resigned in June 2002. As outlined in his employment agreement, Mr. Benson may be awarded an

additional 1,500,000 options upon the occurrence of certain events. (2) 200,000 of these options were performance-based options, which terminated on December 31, 2000. Mr. Lloyd was awarded 10,000 options as a part of an annual award of options to our employees.

During the last fiscal year and as of December 31, 2002, we did not grant stock options to our executive officers listed in the above compensation table. Executive officers were granted stock options in 2003.

The following table is intended to provide information as to the number of stock options exercised by each of the executive officers listed above, the value realized upon exercise of such options, and the number and value of any unexercised options still held by such individuals.

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options/SARs at FY-End (#) Exercisable/ Unexercisable	Value of Unex In-the-Money Options/SARs a End ($) Exercisable/ Unexercisable(1)
James W. Benson	0	0	503,333/ 2,006,667	0/0
Charles H. Lloyd(2)	0	0	697,963/ 0	0/0

(1) For purposes of determining whether options are "in-the-money," we defined fair market value as the five-day weighted average of the closing price of our common stock on the Over-The-Counter Bulletin Board as of March 7, 2003, or $0.46 per share. None of the options listed on the table are "in-the-money."
(2) Mr. Lloyd resigned in June 2002; however, his options will remain exercisable until the five-year anniversary of the grant date of each option, as specified in a separation agreement with him dated May 31, 2002.

REMUNERATION PAID TO DIRECTORS

At our annual meeting on July 16, 2000, our Board of Directors adopted a compensation plan for independent directors whereby they will receive options for attending meetings of the Board as follows: each such director shall receive an option to purchase 5,000 shares for each of two telephonic meetings attended per year, and an option to purchase 10,000 shares for each of two meetings attended in person per year. These directors will not receive additional compensation for attending meetings in excess of those described above. In addition to the above, independent directors will receive $5,000 in options on the date of election or appointment. All such options will be issued pursuant to the Plan at fair market value as of the date of the meeting attended, will vest 50% on the first anniversary date of the date of grant and 50% on the second anniversary date of the date of grant and will expire on the five-year anniversary of the grant date. We do not compensate any of our directors for their services as members of the Board through non-standard arrangements.

The following table sets forth the remuneration paid to our directors during our fiscal year ended December 31, 2002.

	Cash Compensation		Security Grants	
Name	Annual Retainer Fees	Meeting Fees	Consulting Fees / Other Fees	Number of Sh
James W. Benson	---	---	---	---
Charles H. Lloyd	---	---	---	---
Stuart Schaffer	---	---	---	---
Wesley T. Huntress	---	---	---	30,000
Curt Dean Blake	---	---	---	30,000
General Howell M. Estes, III	---	---	---	30,000
Robert S. Walker	---	---	---	25,000
Scott McClendon (1)	---	---	---	15,460(1)

(1) Pursuant to our policy regarding compensation of independent directors, we issued Mr. McClendon options to purchase a total of $5,000 in common shares, or 10,460 shares at a per share price of $0.478, upon acceptance of his position as one of our directors. The exercise price of the shares represents the fair market value on July 19, 2002, the date of issuance. The options vest at a rate of 50% on July 19, 2003 and the remaining 50% on July 19, 2004. Mr. McClendon also received options to purchase 5,000 shares on October 31, 2002 for attendance at a telephonic meeting of the Board of Directors. These options vest as follows: 50% on the one-year anniversary of the grant date and 50% on the two-year anniversary of the grant date.

EMPLOYMENT AGREEMENTS

On November 21, 1997, we entered into a five-year employment agreement with our CEO, Mr. Benson. This agreement provides for compensation of salary and stock as well as stock options. This agreement also prohibits Mr. Benson from competing with us, disclosing any confidential information, or soliciting any of our employees or customers for one year after termination of employment. Our Board of Directors amended the employment contract for Mr. Benson at its meeting on July 16, 2000. The amended agreement provides for the grant of additional options to purchase up to 4,000,000 shares of our common stock upon the occurrence of certain events. Mr. Benson was awarded 2,500,000 options in 1997 and those options were modified in 2000. As outlined in his employment

agreement, Mr. Benson may be awarded an additional 1,500,000 options upon the occurrence of certain events, such options would be immediately exercisable upon grant.

On May 17, 2002, we entered into an "at-will" employment agreement with Mr. Schaffer. The agreement provided for Mr. Schaffer's compensation of salary, benefits and options to purchase up to 450,000 shares of our common stock. The agreement also provided for severance under certain termination provisions. Due to a shift in our short-term focus toward projects rather than products, Mr. Schaffer signed a Separation Agreement and General Release on July 2, 2003. Mr.

Schaffer will receive salary and benefits until August 8, 2003 and will remain on our Board of Directors without further board compensation for a one-year period. Mr. Schaffer will retain certain exercise rights on his vested options of 90,000 shares until the earlier of (i) eighteen (18) months from his resignation as a member of our Board of Directors or other subsequent consulting relationship with us, or (ii) July 19, 2008.

On May 31, 2002, we entered into a Confidential Separation Agreement and General Release of Claims with Mr. Lloyd, our former Chief Operating Officer and Chief Financial Officer. The agreement provided for the resignation of Mr. Lloyd as an officer and director of SpaceDev, Inc. and Integrated Space Systems, Inc., effective June 14, 2002. In exchange for a release of claims and other promises set forth in the agreement, Mr. Lloyd received $36,000 and an extension of the exercise period of each of his non-statutory stock options for a five-year period from the original date of grant. Until May 31, 2003, the agreement also prohibits Mr. Lloyd from soliciting our employees, inducing any customer away from us or representing himself on our behalf.

On February 14, 2003, we entered into an "at-will" employment agreement with Mr. Slansky. The agreement provided for Mr. Slansky's compensation of salary, benefits and options to purchase up to 375,000 shares of our common stock. The agreement also provided for severance under certain termination provisions.

EMPLOYEE BENEFITS

At our 1999 Annual Stockholder Meeting, the shareholders adopted an Incentive Employee Stock Option Plan under which our Board of Directors may grant our employees, directors and affiliates Incentive Stock Options, Supplemental Stock Options and other forms of stock-based compensation, including bonuses or stock purchase rights. Incentive Stock Options, which provide for preferential tax treatment, are only available to employees, including officers, and affiliates, and may not be issued to non-employee directors. The exercise price of the Incentive Stock Options must be 100% of the fair market value of the stock on the date the option is granted. Pursuant to our plan, the exercise price for the Supplemental Stock Options will not be less than 85% of the fair market value of the stock on the date the option is granted. We are required to reserve an amount of common shares equal to the number of shares, which may be purchased as a result of awards made under the Plan.

At the 2000 Annual Stockholder Meeting, the shareholders approved an amendment to the Stock Option Plan of 1999, increasing the number of shares eligible for issuance under the Plan to 30% of the then outstanding common stock and allowing the Board of Directors to make annual adjustments to the Plan to maintain a 30% ratio to outstanding common stock at each annual meeting of the Board of Directors. The Board, at its annual meetings in 2001 and 2002, made no adjustment, as a determination was made that the number of shares then available

under the Plan was sufficient to meet our needs. As of December 31, 2002, 4,184,698 shares were authorized for issuance under the Plan, 3,398,772 of which are currently subject to outstanding options and awards. The Stock Option Plan of 1999 was registered with the U.S. Securities & Exchange Commission on Form S-8.

During the fourth quarter of fiscal year 2002, we issued non-statutory options to purchase 30,000 shares to our independent directors for attendance at our October 18, 2002 Board of Directors meeting. In addition to the Stock Option Plan of 1999, our shareholders adopted the 1999 Employee Stock Purchase Plan, which authorized our Board of Directors to make twelve consecutive offerings of our common stock to our employees. The 1999 Employee Stock Purchase Plan has been instituted. To date, no employees have purchased any shares of common stock under the Plan. We also offer a variety of health, dental, vision, 401(k) and life insurance benefits to our employees in conjunction with our co-employment partner, Administaff.

EQUITY COMPENSATION PLAN INFORMATION

	(a)	(b)	(c)
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensationn plans approved by security holders	2,938,772	$ 0.86	1,245,926
Equity compensation plans not approved by security holders	2,500,000	$ 10.50	0
Total	5,438,772	$ 5.29	1,245,926

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table provides information as July 17, 2003 concerning the beneficial ownership of our common stock by (i) each director, (ii) each named executive officer, (iii) each shareholder known by us to be the beneficial owner of more than 5% of our outstanding Common Stock, and (iv) our directors and

officers as a group. Except as otherwise indicated, the persons named in the table have sole voting and investing power with respect to all shares of Common Stock owned by them.

Title of Class	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	(
..0001 par value common stock	James W. Benson, CEO & Chairman 13855 Stowe Drive Poway, California 92064	12,081,670	(2)
..0001 par value common stock	J. Mark Grosvenor, Director 13855 Stowe Drive Poway, California 92064	1,330,396	(3)
..0001 par value common stock	Curt Dean Blake, Director 13855 Stowe Drive Poway, California 92064	110,930	(4)
..0001 par value common stock	Wesley T. Huntress Jr., Director 13855 Stowe Drive Poway, California 92064	60,515	(5)
..0001 par value common stock	General Howell M. Estes, III, Director 13855 Stowe Drive Poway, California 92064	36,667	(6)
..0001 par value common stock	Robert S. Walker, Director 13855 Stowe Drive Poway, California 92064	34,167	(7)
..0001 par value common stock	Stuart Schaffer, Director & Vice President, Product Development & Marketing 13855 Stowe Drive Poway, California 92064	346,410	(8)
..0001 par value	Scott McClendon, Director	5,230	(9)