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SPACEDEV INC  
Form 10QSB  
May 15, 2006

FORM 10-QSB

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

(Mark One)

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

For the quarterly period ended March 31, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to

Commission File Number 000-28947.

SPACEDEV, INC.

(Exact name of small business issuer as specified in its charter)

Colorado 84-1374613

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

13855 Stowe Drive, Poway, California 92064

(Address of principal executive offices)

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

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

Checkmark whether the issuer (1) filed all reports required to be filed by  
Sections 13 or 15(d) of the Exchange Act during the past 12 months (or for such  
shorter period that the registrant was required to file such reports), and (2)  
has been subject to such filing requirements for the past 90 days.

Yes  No

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

State the number of shares outstanding of each of the issuer's classes of common  
equity, as of the latest practicable date: 28,813,334 shares of Issuer's voting  
common stock were outstanding on May 1, 2006.

Transitional Small Business Disclosure Format: Yes  No

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PAGE

SPACEDEV, INC.  
FORM 10-QSB  
FOR THE QUARTER ENDED MARCH 31, 2006

INDEX	PAGE
PART I -- FINANCIAL INFORMATION	1
ITEM 1. FINANCIAL STATEMENTS	1
Consolidated Balance Sheets	1
Consolidated Statements of Operations	3
Consolidated Statements of Cash Flows	4
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	6
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION	18
Overview	18
Selection of Significant Contracts	20
Results of Operations	21
Liquidity and Capital Resources	25
Cash Position	26
Critical Accounting Standards	26
Recent Accounting Pronouncements	27
Risk Factors	27
ITEM 3. CONTROLS AND PROCEDURES	39
PART II -- OTHER INFORMATION	39
ITEM 1. LEGAL PROCEEDINGS	39
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	39
ITEM 3. DEFAULTS UPON SENIOR SECURITIES	39
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	39
ITEM 5. OTHER INFORMATION	40
ITEM 6. EXHIBITS	40
SIGNATURES	42

PAGE

PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

At March 31, . . . . .	2006	2005
-----	-----	-----
ASSETS		
CURRENT ASSETS		
Cash . . . . .	\$ 1,142,595	\$5,412,949
Accounts receivable . . . . .	5,769,883	620,048
Inventory (Note 2) . . . . .	3,014,626	-
Other current assets . . . . .	213,122	11,306
-----	-----	-----
TOTAL CURRENT ASSETS . . . . .	10,140,226	6,044,303

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FIXED ASSETS - NET . . . . .	3,280,171	293,590
GOODWILL (NOTE 5). . . . .	12,246,362	-
OTHER ASSETS . . . . .	898,762	117,115
-----	-----	-----
	\$26,565,521	\$6,455,008
-----	-----	-----

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

PAGE 1

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

At March 31, . . . . .		2006	
-----	-----	-----	-----
LIABILITIES AND STOCKHOLDERSEQUITY			
CURRENT LIABILITIES			
Accounts payable and accrued expenses (Note 3(a)). . . . .	\$ 2,159,367	\$	4
Accrued payroll, vacation and related taxes. . . . .	1,500,497		2
Billings in excess of costs incurred and estimated earnings (Note 2)	1,635,230		
Other accrued liabilities (Note 2) . . . . .	2,199,130		2
-----	-----	-----	-----
TOTAL CURRENT LIABILITIES . . . . .	7,494,224		9
CAPITALIZED LEASE OBLIGATIONS, LESS CURRENT MATURITIES. . . . .	113,282		
DEFERRED GAIN - ASSETS HELD FOR SALE (NOTE 3(A)). . . . .	801,359		9
-----	-----	-----	-----
TOTAL LIABILITIES . . . . .	8,408,865		1,8
COMMITMENTS AND CONTINGENCIES			
STOCKHOLDERSEQUITY			
Convertible preferred stock, \$.001 par value, 10,000,000 shares authorized, and 253,610 and 250,000 shares issued or outstanding, respectively (Note 4)			
Series C Convertible preferred stock (Note 4(a)) . . . . .	249		
Series D-1 Convertible preferred stock (Note 4 (b)). . . . .	5		
Common stock, \$.0001 par value; 100,000,000 and 50,000,000 shares authorized, and 28,710,496 and 21,373,980 shares issued and outstanding, respectively (Note 4) . . . . .	2,870		
Additional paid-in capital (Note 4). . . . .	32,863,959		18,9
Additional paid-in capital - stock options . . . . .	-		7
Deferred compensation. . . . .	-		(2
Accumulated deficit. . . . .	(14,710,427)		(14,8

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TOTAL STOCKHOLDERSEQUITY. . . . .	18,156,656	4,6
TOTAL LIABILITIES AND STOCKHOLDERSEQUITY. . . . .	\$ 26,565,521	\$ 6,4

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

PAGE 2

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

Three-Months Ending March 31, . . . . .	2006	%	2005
NET SALES. . . . .	\$ 7,174,778	100.0%	\$1,806,889
TOTAL COST OF SALES *. . . . .	5,265,106	73.4%	1,396,835
GROSS MARGIN . . . . .	1,909,672	26.6%	410,054
OPERATING EXPENSES			
Marketing and sales . . . . .	643,560	9.0%	145,017
Research and development. . . . .	81,777	1.1%	8,472
General and administrative. . . . .	1,230,733	17.2%	190,998
TOTAL OPERATING EXPENSES * . . . . .	1,956,070		344,487
INCOME/(LOSS) FROM OPERATIONS. . . . .	(46,398)	-0.6%	65,567
NON-OPERATING INCOME/(EXPENSE)			
Interest income . . . . .	33,615	0.5%	7,960
Interest expense. . . . .	(5,283)	-0.1%	(1,222)
Gain on building sale (Note 3(a)) . . . . .	29,318	0.4%	29,318
TOTAL NON-OPERATING INCOME . . . . .	57,650	0.8%	36,056
INCOME BEFORE TAXES. . . . .	11,252	0.2%	101,623
INCOME TAX PROVISION . . . . .	4,235	0.1%	400
NET INCOME . . . . .	\$ 7,017	0.1%	\$ 101,223
NET INCOME PER SHARE:			
Net income. . . . .	\$ 0		\$ 0
Weighted-Average Shares Outstanding . . . . .	27,276,451		21,291,972
FULLY DILUTED NET INCOME PER SHARE:			
Net income. . . . .	\$ 0		\$ 0
Fully Diluted Weighted-Average Shares Outstanding. . . . .	36,225,300		29,908,287

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\* The following table shows how the Company's stock option expense would be allocated to all exp

Cost of Sales . . . . .	\$	-	\$	-
Marketing and sales . . . . .		-		-
Research and development. . . . .		-		-
General and administrative. . . . .		90,701		-
	\$	90,701	\$	-

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

PAGE 3

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

Three-Months Ending March 31, . . . . .	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income. . . . .	\$ 7,017	\$ 101,223
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization. . . . .	147,370	29,061
Gain on disposal of building sale. . . . .	(29,318)	(29,318)
Stock option expense and stock awards. . . . .	92,876	-
Change in operating assets and liabilities . .	(3,481,569)	135,217
<b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES. . .</b>	<b>(3,263,624)</b>	<b>236,183</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Other assets, capitalized acquisition costs . . . .	(1,066,564)	-
Purchases of fixed assets . . . . .	(324,256)	(43,269)
<b>NET CASH USED IN INVESTING ACTIVITIES . . . . .</b>	<b>(1,390,820)</b>	<b>(43,269)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal payments on notes payable . . . . .	(4,675,832)	(8,997)
Principal payments on capitalized lease obligations	(8,815)	(883)
Dividend payments on Series D-1 Preferred . . . . .	(98,774)	-
Employee stock purchase plan. . . . .	42,767	9,846
Proceeds from issuance of preferred stock . . . . .	4,764,296	151,468
Proceeds from issuance of common stock. . . . .	23,359	-
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES. . . . .</b>	<b>47,001</b>	<b>151,434</b>

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NET (DECREASE)/INCREASE IN CASH. . . . .	(4,607,443)	344,348
CASH AT BEGINNING OF PERIOD. . . . .	5,750,038	5,068,601
CASH AT END OF PERIOD. . . . .	\$ 1,142,595	\$5,412,949

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

PAGE 4

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

Three-Months Ending March 31, . . . . .	2006	2005
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest . . . . .	\$5,283	\$313,978

NONCASH INVESTING AND FINANCING ACTIVITIES:

During the three-months ending March 31, 2006 and 2005 the Company converted \$34,516 and \$11,303 of employee stock purchase plan contributions into 24,885 and 7,915 shares of common stock, respectively.

During the three-months ending March 31, 2006 and 2005 the Company declared dividends payable of \$41,967 and \$42,226, respectively to the holders of its Series C preferred stock.

During the three-months ending March 31, 2005 the Company paid dividends valued at \$60,967 in the form of 39,589 shares of common stock to the holders of its Series C preferred stock.

During the three-months ending March 31, 2006 the Company declared and paid dividends payable of \$98,774 to the holders of its Series D-1 preferred stock.

During the three-months ending March 31, 2006, the Company financed \$125,687 in fixed assets through a capital lease obligation.

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

PAGE 5

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

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The accompanying consolidated financial statements of SpaceDev, Inc. ("the Company") include the accounts of the Company and its subsidiary, Starsys, Inc. and its inactive subsidiary SpaceDev Oklahoma, an Oklahoma corporation. In the opinion of management, the consolidated financial statements reflect all normal and recurring adjustments, which are necessary for a fair presentation of the Company's financial position, results of operations and cash flows as of the dates and for the periods presented. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Consequently, these statements do not include all disclosures normally required by generally accepted accounting principles of the United States of America for annual financial statements nor those normally made in an Annual Report on Form 10-KSB. Accordingly, reference should be made to the Company's Form 10-KSB filed on March 28, 2006 and other reports the Company filed with the U.S. Securities and Exchange Commission for additional disclosures, including a summary of the Company's accounting policies, which have been modified, as a result of the Company's acquisition of Starsys Research Corporation, to include a "percentage-of-completion" method of revenue recognition and inventory policies. The consolidated results of operations for the three-months ending March 31, 2006 are not necessarily indicative of results that may be expected for the fiscal year ending December 31, 2006 or any future period, and the Company makes no representations related thereto.

On March 31, 2004, the Company was awarded a contract from the Missile Defense Agency for approximately \$43.3 million. The microsatellite distributed sensing experiment was intended to analyze, design, develop, fabricate, integrate, test, operate and support a networked cluster of three formation-flying boost phase and midcourse tracking microsatellites and a second cluster of microsatellites with laser communication technology to support national missile defense. We were informed in 2005 that the Missile Defense Agency had re-routed the part of the contract related to the laser communications experiment to another program and that they would not be exercising their option for the additional microsats at this time; however, the contract vehicle remained at \$43.3 million and left open the opportunity for some other purchase to take its place. We estimate that the second cluster would have represented approximately \$10 million of the \$43.3 million contract, and have reduced our current backlog accordingly. We believe the remaining unbilled contract backlog amount of approximately \$22.4 million to be secure. The Company has recognized approximately \$10.9 million in revenue under this contract through March 31, 2006.

Management intends to seek and obtain new government and commercial contracts, use its revolving credit facility only for specially funded programs, if at all, and possibly raise additional equity or debt capital in a public or private offering or fund-raising effort in 2006 or beyond. There can be no assurance that existing contracts will be completed successfully or that new contracts or additional debt or equity financing that may be needed to fund operations will be available or, if available, obtained in sufficient amounts necessary to meet the Company's needs or on terms that are favorable to the Company. Management believes that, if current contracts remain on schedule and are funded as expected, they will be sufficient to fund the Company through 2006.

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

PAGE 6

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### (a) Revenue Recognition

The Company's revenues for the three-months ending March 31, 2006 were derived from United States government cost plus fixed fee (CPFF) contracts, some fixed price contracts and some commercial sales of component and subsystem products that the Company acquired in its acquisition of Starsys, which is compared to primarily CPFF contracts for the same three-month period in 2005. Revenues from the CPFF contracts during the first three-months ending March 31, 2006 and 2005 were recognized as expenses were incurred. Estimated contract profits are taken into earnings in proportion to revenues recorded. Time and material revenues are recognized as services are performed and costs incurred. Certain fixed price contracts were prepared according to the "percentage-of-completion" method of accounting for long-term contracts. The amount of revenues recognized is that portion of the total contract amount that the actual cost expended bears to the anticipated final total cost based on current estimates of cost to complete the project (cost-to-cost method). Total cost that is anticipated to exceed the contract amount, that is, the excess of cost over contract amount is immediately recognized as a loss on the contract. Recognition of profit commences on an individual project only when cost to complete the project can reasonably be estimated and after there has been some meaningful performance achieved on the project. Recognition of losses on projects are taken as soon as the loss is reasonably determinable and accrued on the balance sheet in other accrued liabilities. The current accrual for potential losses on exiting projects represents approximately \$1.6 million. As projects are completed, the accrual is adjusted as projects move toward completion and more accurate estimates are established. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions (when applicable), and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Contract costs include all direct material, direct labor and sub-contractor costs, other costs such as supplies, tools and travel which are specifically related to a particular contract. All other selling, general and administrative costs are expensed as incurred.

### (b) Inventory

Inventory is valued based on lower-of-cost-or-market method and is disbursed on a FIFO (First-In, First-Out) basis, unless required by customer contract to be distributed by specific identification for lot control purposes. Inventory includes raw material inventory, finished goods inventory and work-in-process inventory (which includes "costs and estimated earnings in excess of billings on uncompleted contracts" and represents revenues recognized in excess of amounts billed). 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. Time and material revenues are recognized as services are performed and costs incurred.

## 3. NOTES PAYABLE

### a) Building and Settlement Notes

In December 2002, the Company entered an agreement to sell its interest in its Poway, California headquarters facility. The transaction closed in January 2003. The escrow transaction included the sale of the land and building. Net fixed assets were reduced by approximately \$1.9 million and notes payable were reduced by approximately \$2.4 million while a deferred gain was recorded. In conjunction with the sale, the Company entered into a lease agreement with the buyer to leaseback its facilities. The Company's then Chief Executive Officer provided a guarantee for the leaseback. The gain on the sale of the facility was deferred and amortized in proportion to the gross rental charged to expense



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over the lease term. Deferred gain of \$1,172,720 is being amortized at the rate of \$117,272 per year for ten (10) years ending in January 2013. As of March 31, 2006, the deferred gain was \$801,359. This amortization is included in the Company's non-operating expenses and totaled \$29,318 and \$29,318 for the three-months ending March 31, 2006 and 2005, respectively.

PAGE 7

Deferred Gain consisted of the following:

Three-Months Ended March 31, 2006

Original Deferred Gain	\$1,172,720
Less Amortization 2003	(107,499)
Less Amortization 2004	(117,272)
Less Amortization 2005	(117,272)
Less Amortization 2006	(29,318)
-----	-----
	\$ 801,359
	-----

In 2001, the Company entered into three settlement loan agreements with various vendors. The total of \$171,402 for all three loans called for payments between 24 and 50 months with interest that ranges from 0% to 8%. At March 31, 2005, the outstanding balances on these notes were \$37,130 with interest expense for the three-months ending March 31, 2005 of \$539. (As of March 31, 2006, no notes remained outstanding.)

### b) Revolving Credit Facility.

On June 3, 2003, the Company entered into a Security Agreement, Secured Convertible Note, Registration Rights Agreement and Common Stock Purchase Warrant, with the Laurus Master Fund, Ltd. ("Laurus"). Pursuant to the agreements, the Company received a \$1 million revolving credit facility in the form of a three-year Convertible Note secured by its assets subject to the amount of eligible accounts receivables. The net proceeds from the Convertible Note were used for general working capital purposes. Advances on the Convertible Note were repaid at the Company's option, in cash or through the issuance of the Company's shares of common stock. The Convertible Note carries an interest rate of Wall Street Journal Prime plus 0.75% on any outstanding balance. In addition, the Company is required to pay a collateral management payment of 0.55% of the average aggregate outstanding balance during the month plus an unused line payment of 0.20% per annum. Availability of funds under the revolving credit facility is based on the Company's accounts receivable, except as waivers are provided by Laurus. Laurus has exercised its conversion rights from time to time on outstanding balances. Laurus converted a total of 3,406,417 shares to reduce the debt by an aggregate of \$2,500,000 since the inception of the revolving credit facility. There was no outstanding balance on the revolving credit facility at March 31, 2006 and 2005 and there have been no conversions during the first three months of 2006 and 2005.

In conjunction with this transaction, Laurus was paid a fee of \$20,000 for the first year, which was expensed as additional interest expense in 2003. The Company is required to pay a continuation fee of \$10,000 each year thereafter. In addition, Laurus received a warrant to purchase 200,000 shares of the

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Company's common stock for the initial \$1 million revolving credit facility, as stated herein. The warrant exercise price was computed as follows: \$0.63 per share for the purchase of up to 125,000 shares; \$0.69 per share for the purchase of an additional 50,000 shares; and \$0.80 per share for the purchase of an additional 25,000 shares. The warrant exercise price may be paid in cash, in shares of the Company's common stock, or by a combination of both. The warrant expiration date is June 3, 2008. In addition to the initial warrant, the Company issued two additional warrants: 1) to purchase 50,000 shares at an exercise price of \$1.0625 per share in relation to the \$500,000 revolving credit facility expansion convertible at \$0.85 per share, which warrant was exercised by Laurus on April 19, 2005; and, 2) to purchase 50,000 shares at an exercise price of \$1.925 per share in relation to the \$1 million revolving credit facility expansion convertible at \$1.00 per share.

The Company may terminate its revolving credit facility with Laurus before the end of the initial three year term for a fee; or, the agreement will expire on June 3, 2006.

PAGE 8

#### 4. STOCKHOLDER'S EQUITY - PREFERRED STOCK, COMMON STOCK AND WARRANTS PREFERRED STOCK

##### a) Series C Preferred Stock.

On August 25, 2004, the Company entered into a Securities Purchase Agreement with the Laurus Master Fund, Ltd., whereby the Company issued 250,000 shares of its Series C Non-Redeemable Convertible Preferred Stock, par value \$0.001 per share (the "Series C Preferred Shares"), to Laurus for an aggregate purchase price of \$2,500,000 or \$10.00 per share (the "Stated Value"). The Series C Preferred Shares are convertible into shares of the Company's common stock at a rate of \$1.54 per share at any time after the date of issuance, and accrue quarterly, cumulative dividends at a rate of 6.85%. The first payment was due on January 1, 2005. As of March 31, 2006 and 2005, approximately \$99,000 and \$42,000 has been accrued for dividends and are payable in cash or shares of our common stock at the holder's option with the exception that dividends must be paid in shares of our common stock for up to 25% of the aggregate dollar trading volume if the fair market value of the Company's common stock for the 20-days preceding the conversion date exceeds 120% of the conversion rate. On January 11, 2005, \$60,967 of accrued dividends were paid in the form of 39,589 shares of the Company's common stock. Also, on May 5, 2005, \$56,301 of accrued dividends were paid in the form of 36,559 shares of the Company's common stock from dividends accrued and on September 28, 2005, \$57,708 of accrued dividends were paid in the form of 37,473 shares of the Company's common stock. The Series C Preferred Shares are redeemable by the Company in whole or in part at any time after issuance for (a) 115% of the Stated Value if the average closing price of the common stock for the 22 days immediately preceding the date of conversion does not exceed \$1.48 per share or (b) the Stated Value if the average closing price of our common stock for the 22 days immediately preceding the date of conversion exceeds the Stated Value. The Series C Preferred Shares have a liquidation right equal to the Stated Value upon the Company's dissolution, liquidation or winding-up. The Series C Preferred Shares have no voting rights, except as required by law.

In conjunction with the Series C Preferred Shares, the Company issued a five-year common stock purchase warrant to Laurus for the purchase of 487,000 shares of the Company's common stock at an exercise price of \$1.77 per share.

##### b) Series D-1 Preferred Stock.

On January 12, 2006, the Company entered into a Securities Purchase Agreement

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with a limited number of institutional accredited investors, including Omicron Capital, Tailwind Capital, Bristol Capital Management, Nite Capital and the Laurus Master Fund, Ltd. On January 13, 2006, the Company issued and sold to these investors 5,150 shares of our Series D-1 Amortizing Convertible Perpetual Preferred Stock, par value \$0.001 per share, for an aggregate purchase price of \$5,150,000, or \$1,000 per share. The Company also issued various warrants to these investors as described below. The Company paid cash fees and expenses of \$119,209 to a finder for the introduction of potential investors in this financing, and paid \$60,000 to the lead investor's counsel for legal expenses incurred in the transaction. The preferred shares are convertible into shares of the Company's common stock at a rate of \$1.48 per share and accrue quarterly, cumulative dividends at a rate of LIBOR plus 4% on the first day of the applicable quarter with the first payment due on April 1, 2006. As of March 31, 2006, the Company accrued and paid approximately \$99,000 for dividends in cash.

Under the purchase agreement, from the date of the effectiveness of the initial registration statement filed pursuant to the registration rights agreement (February 15, 2006), until the one-year anniversary of that date, if: (1) on any trading day during such period the volume weighted average price of the Company's common stock for each of the 20 trading days immediately prior to such date exceeds \$1.63; and, (2) the average daily trading volume of the Company's common stock exceeds \$100,000 on each of those days, then the Company has the option, subject to a number of additional conditions, to put to the investors "units" at \$1,000 per unit for an aggregate purchase price of up to \$2,000,000 (or a lesser amount to the extent the preferred stock warrants issued at the

PAGE 9

initial closing of the financing, which are described below, have been exercised to purchase these units). Each "unit" consists of one share of Series D-1 Preferred Stock and a common stock warrant, which entitles the holders to purchase up to an aggregate of 440,829 shares of common stock at an exercise price of \$1.51 and otherwise has the same terms as the warrants described in the following paragraph.

Certain warrants the Company issued to the Series D-1 investors at the closing entitle the investors to purchase up to an aggregate of 1,135,138 shares of the Company's common stock at an exercise price of \$1.51 per share. The warrants are exercisable for five years following the date of grant. The warrants have "ratchet" anti-dilution provisions reducing the warrant exercise price if the Company issues equity securities (other than in specified exempt transactions) at an effective price below the warrant exercise price to such lower exercise price.

The Company also issued certain other warrants to the Series D-1 investors at the closing (the "preferred stock warrants"). These warrants entitle the holder to purchase an aggregate number of 2,000 "units", which are identical to the "units" described above, at an exercise price of \$1,000 per unit. The preferred stock warrants are exercisable from the effective date (February 15, 2006) until the one-year anniversary of that date. If any units subject to the preferred stock warrants remain unsold after (1) their expiration date and (2) the exercise of the Company's put option, if applicable, and any holder of a preferred stock warrant issued in the financing has exercised the warrant in full, then the preferred stock warrant grants that holder the right to purchase 440,829 with a strike price of \$1.51 per share, the warrant has a five year expiration date once issued.

Other Provisions.

The purchase agreement contains a number of covenants by the Company, which

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include:

- A grant of preemptive rights to the investors to participate in future financings until the first anniversary of the closing date of the financing;
- An agreement not to issue any shares of the Company's common stock or securities or other rights to acquire shares of common stock until six (6) months after the effective date, except under specified conditions intended to ensure the terms are no less favorable to the Company than the terms of this financing; and,
- An agreement not to effect any transaction involving the issuance of securities convertible, exercisable or exchangeable for the Company's common stock at a price per share or rate which may change over time, which the Company refers to as a variable-rate transaction, so long as any shares of Series D-1 Preferred Stock are outstanding.

In connection with this financing, Laurus consented to and waived certain contractual rights in respect of the authorization and issuance of one or more series of Series D-1 Preferred Stock and the other transactions described below, and certain other transactions. The Company paid Laurus Capital Management, L.L.C., and the manager of Laurus, \$87,000 in connection with Laurus's delivery of the consent and \$1,000 to Laurus' counsel for their related fees.

PAGE 10

### COMMON STOCK AND WARRANTS

The Company adopted FAS 123(R) to account for its stock-based compensation beginning January 1, 2006. Previously, the Company elected to account for its stock-based compensation plans under APB 25. The Company computed, for pro forma disclosure purposes, the value of all options granted during the three--months ending March 31, 2005 using the minimum value method as prescribed by SFAS 123 and amended by SFAS 148. Under this method, the Company used the risk-free interest rate at the date of grant, the expected volatility, the expected dividend yield and the expected life of the options to determine the fair value of options granted. The risk-free interest rates ranged from 6.0% to 6.5%, expected volatility was 117%, the dividend yield was assumed to be zero, and the expected life of the options was assumed to be three to five years based on the average vesting period of options granted.

If the Company had accounted for its options in accordance with SFAS 123(R) in 2005, the total value of options granted during the three-month period ending March 31, 2005 would have been amortized on a pro forma basis over the vesting period of the options. Thus, the Company's consolidated net income (loss) would have been as follows:

Net Income (Loss) . . . . .	2005
<hr style="border-top: 1px dashed black;"/>	
As reported. . . . .	\$ 101,223
Add: Stock based employee compensation expense included in reported net income. . . . .	\$ -
 Less: Stock based employee compensation expense	

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determined under the fair value based method for all awards . . . . .	\$ (213,553)
Pro forma. . . . .	\$ (112,330)

For the quarter ended March 31, 2006, the Company expensed approximately \$91,000 of stock option expenses due to SFAS 123(R) in its financial statements.

### 5. GOODWILL

On January 31, 2006, SpaceDev acquired Starsys Research Corporation and in accordance with U.S. generally accepted accounting principles, the merger was accounted for using the purchase method of accounting. Under the purchase method of accounting, the total estimated purchase price was allocated to Starsys' net tangible assets and identifiable intangible assets based on their fair values as of the date of completion of the merger. The excess of the purchase price over those fair values was recorded as goodwill. Goodwill is not amortized but is tested for impairment at least annually. The combined company will incur additional amortization expense based on the identifiable amortizable intangible assets acquired pursuant to the merger agreement and their relative useful lives. Additionally, to the extent the value of goodwill or identifiable intangible assets or other long-lived assets become impaired, the combined company may be required to record material charges relating to the impairment. The goodwill balance as of March 31, 2006 was approximately \$12.2 million.

PAGE 11

The following is a schedule of the goodwill incurred on the Starsys acquisition.

Starsys Total Assets . . . . .	\$ (7,851,494)
Starsys Total Liabilities. . . . .	13,054,140
Cash to Starsys Stockholders . . . . .	410,791
Equity to Starsys Stockholders . . . . .	5,576,846
Fees Associated with Acquisition . . . . .	1,056,079
	\$12,246,362

### 6. NEW ACCOUNTING PRONOUNCEMENTS

There were no recent Accounting Pronouncements that affected the Company during the first quarter of 2006. For past pronouncements, please refer the Company's 10-KSB filed on March 28, 2006.

### 7. CHANGE IN ACCOUNTING PRINCIPLE AND ACCOUNTING FOR SHARE-BASED COMPENSATION

The Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004) (123(R)) on January

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1, 2006. Upon the adoption of SFAS No. 123(R), compensation costs associated with share-based compensation and stock option awards will be recorded to expense over the requisite period(s) associated with the stock or options. Prior to the adoption of SFAS 123(R), the Company accounted for share-based compensation and stock option awards issued to employees, directors and officers under the recognition and measurement principles of Accounting Principles Board (APB) No. 25, Accounting for Stock Issued to Employees, and related interpretations. Generally, no share-based employee compensation expense was recognized for stock option grants, as all options granted had an exercise price equal to the fair market value of the underlying common stock at the date of grant. Similarly, no compensation expense had been recognized under the Company's 1999 Employee Stock Purchase Plan (ESPP).

As noted above, in the first quarter 2006, the Company adopted SFAS No. 123(R), which requires companies to measure an equity instrument based on the grant-date fair value of the award and expense the value. The Company uses the Black-Scholes pricing model to determine the fair value of its options on the measurement date. The cost is recognized over the requisite period (usually the vesting period). During the first quarter 2006, the Company had stock option expense of \$90,701 related to a new officer stock option award coincident with the Starsys merger. Without the adoptions of SFAS No. 123(R), the Company's operating income, net income and net income per share would have been increased to the pro forma non-GAAP amounts indicated below:

PAGE 12

SPACEDEV, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS - SUPPLEMENTAL SCHEDULE  
(UNAUDITED)

Three-Months Ending March 31, . . . . .	2006	%	2005
GAAP OPERATING INCOME . . . . .	\$ (46,398)	-0.6%	\$ 65,567
FAS 123(R) stock option expense . . . . .	90,701	1.3%	-
NON-GAAP OPERATING INCOME . . . . .	44,303	0.6%	65,567
NON-OPERATING INCOME/(EXPENSE)			
Interest income . . . . .	33,615	0.5%	7,960
Interest expense . . . . .	(5,283)	-0.1%	(1,222)
Gain on building sale . . . . .	29,318	0.4%	29,318
TOTAL NON-OPERATING INCOME . . . . .	57,650	0.8%	36,056
NON-GAAP NET INCOME BEFORE TAXES . . . . .	\$ 101,953	1.4%	\$ 101,623
INCOME TAX PROVISION . . . . .	4,235	0.1%	400
NON-GAAP NET INCOME . . . . .	\$ 97,718	1.4%	\$ 101,223
NET INCOME PER SHARE:			
Non-GAAP Net Income Per Share . . . . .	\$ 0.00	0.0%	\$ 0.00
Weighted-Average Shares Outstanding . . . . .	27,276,451		21,291,972
FULLY DILUTED NET INCOME PER SHARE:			

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Non-GAAP Fully Diluted Income Per Share . . . . .	\$ 0.00	\$ 0.00
Fully Diluted Weighted-Average Shares Outstanding.	36,225,300	29,908,287

The Company believes that evaluating its ongoing operating results with these non-GAAP measurements may be useful as a supplement to its standard GAAP financial measurement presentation. Accordingly, the Company has chosen certain non-GAAP financial information to evaluate its ongoing operations and for internal planning and forecasting purposes. The Company believes that non-GAAP financial measures should be considered in addition to, and not a substitute for, financial information prepared in accordance with GAAP. The Company presents such non-GAAP financial measures in reporting its financial results to provide additional and supplemental disclosure to evaluate operating results. Whenever the Company uses a non-GAAP financial measurement, it provides a reconciliation of the non-GAAP financial measure to the most closely applicable GAAP financial measurement.

8. UNAUDITED PRO FORMA COMBINED CONSOLIDATED STATEMENTS OF OPERATIONS

The following unaudited pro forma combined statements of operations give effect to the merger of SpaceDev and Starsys using the purchase method of accounting, as required by Statement of Financial Accounting Standard No. 141, "Business Combinations." The Company acquired Starsys Research Corporation on January 31, 2006 and is "accounting acquirer" for accounting purposes. Under this method of accounting, the combined company will allocate the purchase price to the fair value of assets of Starsys deemed to be acquired, including identifiable intangible assets and goodwill. The purchase price allocation is subject to revision when the combined company obtains additional information regarding asset valuation. The unaudited pro forma combined statements of operations are based on respective historical consolidated financial statements and the accompanying notes of the Company, and those of Starsys included herein.

The unaudited pro forma combined statements of operations for the three months ended March 31, 2006 assume the merger took place on January 1, 2006 and combines SpaceDev's historical statement of operations for the year ended December 31, 2005 with Starsys' historical statement of operations for the year ended December 31, 2005 as if the merger took place on January 1, 2005. The unaudited pro forma combined statements of operations should be read in conjunction with the related notes included in this Form 10-QSB and the consolidated audited financial statements of SpaceDev, Inc. The unaudited pro forma combined statements of operations are not necessarily indicative of what the actual results of operations and financial position would have been had the merger taken place on January 1 of each period presented and do not indicate future results of operations.

UNAUDITED PRO FORMA COMBINED CONSOLIDATED STATEMENT OF OPERATIONS  
(UNAUDITED)

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MARCH 31, 2006

	SPACEDEV	STARSYS	PRO FORMA ADJUSTMENTS	PRO FO
NET SALES. . . . .	\$ 2,889,592	\$5,920,870	\$ (51,345)	\$ 8,75
COST OF SALES. . . . .	2,097,469	4,443,218	-	6,54
GROSS MARGIN . . . . .	792,123	1,477,652	(51,345)	2,21
OPERATING EXPENSES				
Marketing and sales expense . . .	497,614	265,300	(51,345)	71
Research and development. . . . .	67,412	9,082	-	7
General and administrative. . . .	364,718	1,176,493	-	1,54
TOTAL OPERATING EXPENSES . . . . .	929,744	1,450,875	(51,345)	2,32
INCOME/(LOSS) FROM OPERATIONS. . . .	(137,621)	26,777	-	(11
NON-OPERATING INCOME/(EXPENSE)				
Interest income . . . . .	33,615	28,306	-	6
Interest expense. . . . .	(110)	(27,656)	-	(2
Gain on building sale . . . . .	29,318	-	-	2
TOTAL NON-OPERATING INCOME/(EXPENSE)	62,823	650	-	6
INCOME/(LOSS) BEFORE INCOME TAXES. .	(74,798)	27,427	-	(4
Income tax provision . . . . .	4,200	35	-	
NET INCOME/(LOSS). . . . .	\$ (78,998)	\$ 27,392	\$ -	(5
NET INCOME/(LOSS) PER SHARE:				
Net Income/(Loss) . . . . .	\$ (0.00)	\$ 0.05	\$ -	\$
Shares Outstanding . . . . .	28,710,496	520,000	(520,000)	28,71

PAGE 15

UNAUDITED PRO FORMA COMBINED CONSOLIDATED STATEMENT OF OPERATIONS  
(UNAUDITED)

DECEMBER 31, 2005

	SPACEDEV	STARSYS	PRO FORMA ADJUSTMENTS	PRO F
NET SALES. . . . .	\$ 9,005,011	\$17,762,730	\$ -	\$26,7
COST OF SALES. . . . .	6,905,902	14,721,176	-	\$21,6



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GROSS MARGIN . . . . .	2,099,109	3,041,554	-	\$ 5,1
OPERATING EXPENSES				
Marketing and sales expense . . .	673,636	-	673,636	
General and administrative. . . .	1,113,973	6,000,676	-	7,1
TOTAL OPERATING EXPENSES . . . . .	1,787,609	6,000,676	-	7,7
INCOME/(LOSS) FROM OPERATIONS. . . .	311,500	(2,959,122)	-	(2,6
NON-OPERATING INCOME/(EXPENSE)				
Interest income . . . . .	105,840	-	-	1
Rental income . . . . .	-	88,146	88,146	
Interest expense. . . . .	(2,873)	(506,525)	-	(5
Gain on building sale . . . . .	117,272	-	-	1
Loan fee - equity compensation. . .	(28,875)	-	-	(
TOTAL NON-OPERATING INCOME/(EXPENSE)	191,364	(418,379)	-	(2
INCOME/(LOSS) BEFORE INCOME TAXES. .	502,864	(3,377,501)	-	(2,8
Income tax provision . . . . .	1,600	-	-	
NET INCOME/(LOSS). . . . .	\$ 501,264	\$ (3,377,501)	\$ -	(2,8
NET INCOME/(LOSS) PER SHARE:				
Net Income/(Loss) . . . . .	\$ 0.02	\$ (6.49)	\$ (0.08)	
Shares Outstanding . . . . .	29,030,858	520,447	5,357,143	34,3

The unaudited pro forma combined consolidated information reflects our best estimates. The actual results of operations may have differed from the pro forma amounts reflected herein because of various factors, including, without limitation, access to additional information, changes in value and changes in operating results. However, the Company believes that any final adjustments will not be material to the statement of operations.

9. SUBSEQUENT EVENTS

On April 1, 2006, the Company was awarded the third task order on a \$43-million contract with the Missile Defense Agency to conduct a micro-satellite Distributed Sensing Experiment (DSE), as well as other micro-satellite studies, as required. The second Task Order was awarded on October 20, 2004 (although

PAGE 16

effective October 1, 2004) and was completed on March 31, 2006. The commencement of Phase III of this contract followed a successful DSE Critical Design Review held from March 7 through March 8, 2006. The third Task Order was awarded for a total of \$1,547,266 and will run through May 31, 2006.

PAGE 17

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

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The following discussion should be read in conjunction with the Company's consolidated financial statements and the notes thereto and the other financial information appearing elsewhere in this document. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation our fiscal year 2005 Form 10-KSB and quarterly 10-QSB filings.

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

Actual results could differ materially from those anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to those identified in the "Risk Factors" subsection below.

### OVERVIEW

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

We acquired Starsys Research Corporation on January 31, 2006 in a tax-free forward triangular merger, renamed the company Starsys, Inc., and now hold it as a wholly-owned subsidiary of SpaceDev. Starsys is engaged in the design and manufacture of mechanical and electromechanical subsystems and components for spacecraft. Starsys' subsystems enable critical spacecraft functions such as pointing solar arrays and communication antennas and restraining, deploying and actuating moving spacecraft components. Starsys manufactures a wide range of products that include bi-axis gimbals, flat plate gimbals, solar array pointing mechanisms, deployable booms, separation systems, thermal louvers, actuators, restraint devices and cover systems. Starsys' products are sold both as "off-the-shelf" catalog products, which represent previously qualified devices with spaceflight history, and as custom systems that are developed for specific applications. Starsys' products are typically sold directly to spacecraft

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manufacturers. Starsys' customer base is segregated into three major segments:

PAGE 18

(1) domestic and international commercial spacecraft (communication and imaging satellites), (2) civil spacecraft (NASA) that are primarily scientific in nature and (3) defense spacecraft that support the United States' military capability. Starsys also offers products to non-space customers, including aerospace, maritime, and industrial customers.

Starsys' engineering and manufacturing capabilities position the company to provide both mechanical and electromechanical subsystems for spacecraft. Starsys' strategy is to identify opportunities to develop products from custom mechanical and electromechanical subsystems. To extend the product life cycle, Starsys has developed and expanded a "product platforms" business model. Product platforms are subsystems for which non-recurring and development engineering have been completed and for which there is continued customer demand. Starsys' product offerings currently include High Output Paraffin ("HOP") actuators, hinges, battery bypass switches, thermal louvers, bi-axial gimbals and solar array drives, among others. The product life cycle for this type of product within the space industry is approximately 15 years.

The acquisition of Starsys fundamentally changed our profile. Starsys is a mature operating company with 2005 revenues of approximately \$18 million and 2005 losses of approximately \$3.4 million. We believe there are numerous potential synergies between the historic SpaceDev business, and Starsys' business, including but not limited to providing SpaceDev with a production capability as its technologies migrate from advanced systems to products, access to quality facilities and a strong market of aerospace engineers, a diversification of customers and revenues, and the ability to bid on larger and more vertically integrated programs and projects.

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

We have been awarded, have successfully concluded or are successfully concluding contracts from such esteemed government, university and commercial customers as the Air Force Research Laboratory, Boeing, the California Space Authority, the Defense Advanced Research Projects Agency, NASA's Jet Propulsion Laboratory, Lockheed Martin, Lunar Enterprise Corporation, Malin Space Science Systems, the Missile Defense Agency (formerly the "Ballistic Missile Defense Organization"), the National Reconnaissance Office, Scaled Composites and the University of California at Berkeley via NASA.

During the first three months of 2006, 85% of our net sales were generated from direct government contracts, 7% was generated from government-related work through subcontracts with others, and 8% was generated from commercial contracts. For the same three month period in 2005, approximately 95% of our net sales were generated by government or government-related work. We will continue to seek both government and commercial business and anticipate that net sales from government sources will continue to represent in excess of 80% of our net sales for the next several years. Currently, we are focusing on the domestic

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United States government market, which we believe is only about one-half of the global government market for our technology, products and services. Although we are interested in exploring increased international revenue and contract opportunities, we are restricted by export control regulations, including International Traffic in Arms Regulations, which may limit our ability to develop market opportunities outside the United States on some of our products.

At this time, over 70% of our forecasted sales for 2006 are under contract or near contract award. We may not be able to win enough new business to achieve our targeted growth projection or to maintain a positive cash flow position. During the first three months of 2006 we submitted approximately twenty-five bids for government or commercial programs ranging from \$25,000 to \$350 million and continued our work with the United States Congress to identify directed funding for our programs.

PAGE 19

In order to perform the Missile Defense Agency contract (described below) on schedule and successfully execute other existing and new business opportunities, we must substantially increase our staff and hire new engineers or subcontract the work to third parties. We are actively seeking to hire spacecraft and propulsion engineers, and we are investigating various partnership arrangements to increase resource availability.

### SELECTION OF SIGNIFICANT CONTRACTS

On July 18, 2005, we were awarded a subcontract to provide scientific, engineering, development and programmatic support to the development and demonstration of innovative SSA (space situational awareness) nanosatellite  
(