

AD ASTRA ROCKET COMPANY and SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

With Independent Auditor's Report

As of and for the Years Ended December 31, 2016 and 2015

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
TABLE OF CONTENTS

	<u>Page</u>
Independent Auditor's Report	1
Consolidated Financial Statements:	
Consolidated Balance Sheets as of December 31, 2016 and 2015	3
Consolidated Statements of Operations for the years ended December 31, 2016 and 2015	4
Consolidated Statements of Changes in Stockholders' Deficit for the years ended December 31, 2016 and 2015	5
Consolidated Statements of Cash Flows for the years ended December 31, 2016 and 2015	6
Notes to Consolidated Financial Statements	7



Independent Auditor's Report

To the Board of Directors and Stockholders
Ad Astra Rocket Company

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Ad Astra Rocket Company and Subsidiaries (the "Company") which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the consolidated statements of operations, changes in stockholders' deficit and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Independent Auditor's Report, continued

Emphasis of Matter

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has experienced recurring net losses and negative cash flows from operations. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with regard to this matter are also discussed in Note 2. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Ham, Langston & Bregina, L.L.P.

Houston, Texas
March 10, 2017

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
FOR THE YEARS ENDED DECEMBER 31, 2016 and 2015

<u>ASSETS</u>	<u>2016</u>	<u>2015</u>
Current assets:		
Cash	\$ 302,303	\$ 346,609
Accounts receivable	15,478	34,989
Prepaid expenses	<u>18,109</u>	<u>19,752</u>
Total current assets	<u>335,890</u>	<u>401,350</u>
Property and equipment, net	458,846	185,282
Other assets	<u>59,934</u>	<u>62,434</u>
Total assets	<u>\$ 854,670</u>	<u>\$ 649,066</u>
<u>LIABILITIES AND STOCKHOLDERS' DEFICIT</u>		
Current liabilities:		
Line of credit, related party	\$ 408,000	\$ 408,000
Notes payable, current portion	243,642	8,063
Notes payable, related party	500,000	500,000
Accounts payable	133,865	107,072
Accounts payable, related party	279,656	279,656
Accrued liabilities	886,217	881,471
Interest payable to related party	<u>174,071</u>	<u>140,458</u>
Total current liabilities	2,625,451	2,324,720
Notes Payable, net of current portion	<u>179,142</u>	<u>231,478</u>
Total liabilities	<u>2,804,593</u>	<u>2,556,198</u>
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock:		
Series A, \$0.01 par value, 2,200 shares authorized; 369 shares issued and outstanding	4	4
Series C, \$0.01 par value, 1,000 shares authorized; 26 shares issued and outstanding	-	-
Common stock, \$0.01 par value, 75,000,000 shares authorized; 21,000,713 and 20,997,713 shares issued and outstanding	210,008	209,978
Additional paid-in capital	33,807,880	33,746,700
Accumulated deficit	<u>(35,967,815)</u>	<u>(35,863,814)</u>
Total stockholders' deficit	<u>(1,949,923)</u>	<u>(1,907,132)</u>
Total liabilities and stockholders' deficit	<u>\$ 854,670</u>	<u>\$ 649,066</u>

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

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
General and administrative expenses:		
Payroll expense	\$ 1,617,747	\$ 1,186,505
Professional fees	109,400	86,518
Other general and administrative expenses	<u>1,582,086</u>	<u>1,052,181</u>
Total general and administrative expenses	3,309,233	2,325,204
Other income (expense):		
Interest income	12	9
Interest expense	(67,784)	(65,580)
Other income, net	<u>3,273,004</u>	<u>1,773,176</u>
Total other income (expense), net	<u>3,205,232</u>	<u>1,707,605</u>
Net loss before benefit (provision) for income taxes	(104,001)	(617,599)
Benefit (provision) for income taxes	<u>-</u>	<u>-</u>
Net loss	<u>\$ (104,001)</u>	<u>\$ (617,599)</u>
Basic and diluted loss per share	<u>\$ (.00)</u>	<u>\$ (.03)</u>
Basic weighted-average shares outstanding	<u>20,997,811</u>	<u>20,917,875</u>

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

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT
FOR THE YEARS ENDED DECEMBER 31, 2016 and 2015

	<u>Preferred Stock</u>				<u>Common Stock</u>		<u>Additional</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Series A</u>	<u>Amount</u>	<u>Series C</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Paid-In</u>	<u>Deficit</u>	<u>Stockholders</u>
	<u>Shares</u>		<u>Shares</u>				<u>Capital</u>		<u>Equity(Deficit)</u>
Balance as of December 31, 2014	369	\$ 4	26	\$ -	20,835,685	\$ 208,357	\$32,866,063	\$(35,246,215)	\$ (2,171,791)
Common stock issued for cash, net of issuance costs of \$1,443	-	-	-	-	162,028	1,621	819,105	-	820,726
Compensatory stock options granted	-	-	-	-	-	-	61,532	-	61,532
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(617,599)</u>	<u>(617,599)</u>
Balance as of December 31, 2015	369	4	26	-	20,997,713	209,978	33,746,700	(35,863,814)	(1,907,132)
Common stock issued for cash	-	-	-	-	3,000	30	12,480	-	12,510
Compensatory stock options granted	-	-	-	-	-	-	48,700	-	48,700
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(104,001)</u>	<u>(104,001)</u>
Balance as of December 31, 2016	<u>369</u>	<u>\$ 4</u>	<u>26</u>	<u>\$ -</u>	<u>21,000,713</u>	<u>\$ 210,008</u>	<u>\$ 33,807,880</u>	<u>\$(35,967,815)</u>	<u>\$ (1,949,923)</u>

The accompanying notes are an integral part of consolidated financial statements

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Net loss	\$ (104,001)	\$ (617,599)
Adjustments to reconcile net loss to net cash provided (used) in operating activities:		
Depreciation and amortization expense	101,553	46,726
Loss from disposal of fixed assets	1,932	-
Compensatory element of stock option grants	48,700	61,532
Changes in operating assets and liabilities:		
Accounts receivable	19,511	(30,558)
Prepaid expenses	1,643	(5,950)
Accounts payable and accrued liabilities	31,539	(223,679)
Accounts payable, related party	-	79,763
Interest payable, related party	<u>33,613</u>	<u>42,633</u>
Net cash provided (used) in operating activities	<u>134,490</u>	<u>(647,132)</u>
Cash flows from investing activities:		
Purchases of equipment	<u>(174,549)</u>	<u>(179,600)</u>
Net cash used in investing activities	<u>(174,549)</u>	<u>(179,600)</u>
Cash flows from financing activities:		
Payments on notes payable	(16,757)	(17,325)
Proceeds from notes payable, related party	-	250,000
Net proceeds from Issuance of common stock	<u>12,510</u>	<u>820,726</u>
Net cash (used) provided by financing activities	<u>(4,247)</u>	<u>1,053,401</u>
Net (decrease) increase in cash and cash equivalents	(44,306)	226,669
Cash and cash equivalents, beginning of period	<u>346,609</u>	<u>119,940</u>
Cash and cash equivalents, end of period	<u>\$ 302,303</u>	<u>\$ 346,609</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	<u>\$ 34,013</u>	<u>\$ 20,882</u>
Non-cash Investing and Financing Activities:		
Solar equipment acquired for directly related debt	<u>\$ 200,000</u>	<u>\$ -</u>

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

AD ASTRA ROCKET COMPANY and SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Ad Astra Rocket Company and Subsidiaries (the "Company" or "AARC") was incorporated on January 14, 2005 and officially organized on July 15, 2005 in Houston, Texas. The Company engages in research and development of technology and manufactures prototypes based on its research and development, including work on advanced plasma technology, the Variable Specific Impulse Magnetoplasma Rocket ("VASIMR") and Hydrogen transportation systems.

Basis of Consolidation

The consolidated financial statements include the accounts of the Company's direct, wholly-owned subsidiaries: Ad Astra Rocket Company (Costa Rica) S.R.L. incorporated in Costa Rica, and Ad Astra Servicios Energeticos Y Ambientales, Inc. a Delaware corporation. The consolidated financial statements also include the accounts of the Company's indirect, wholly owned subsidiary Ad Astra Servicios Energeticos y Ambientales AASEA, S.R.L., a Costa Rican corporation which is a direct, wholly-owned subsidiary of Ad Astra Servicios Energéticos Y Ambientales, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation.

The financial position, results of operations and cash flows of the Company's foreign subsidiary are determined using the United States dollar as the functional currency.

Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers all short-term investments with an original maturity of three months or less to be cash equivalents.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities. These estimates also impact disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the related reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management believes that its estimates are reasonable.

Account Receivable and Allowance for Doubtful Accounts

The Company provides services to entities located primarily in the United States and Costa Rica. The Company grants credit only after an evaluation of financial condition. The allowance for doubtful accounts reflects management's best estimate of probable losses inherent in the accounts receivable balance. The Company determines the allowance based on known troubled accounts, historical experience, and other currently available evidence. At December 31, 2016 and 2015, there was no allowance as management believes all accounts are collectible.

Property and Equipment

Property and equipment are stated at cost. Depreciation of property and equipment is provided using the straight-line method for financial reporting purposes based on the estimated useful lives of the assets as follows:

	<u>Years</u>
Computers and software	3
Laboratory equipment	5
Machine shop equipment	5
Solar Power equipment	10

Leasehold improvements are amortized on a straight-line basis based on the shorter of the corresponding lease term or useful life. Expenditures for major renewals and improvements that extend the useful lives of the property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred. The cost and accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts and any resulting gain or loss is reflected in operations.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies, continued

Impairment of Long-Lived Assets

If facts and circumstances indicate that the carrying value of a long-lived asset, including intangible assets, may be impaired, an evaluation of recoverability is performed by comparing the estimated future undiscounted cash flows associated with the asset or the asset's estimated fair value to the asset's carrying amount to determine if a write-down to market value or discounted cash flow is required. During the years ended December 31, 2016 and 2015, the Company did not record any impairment expense related to long-lived assets.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred income taxes are recorded to reflect the tax consequences on future years of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts at the end of the reporting period. The Company provides a valuation allowance to reduce deferred tax assets to their net realizable value.

The Company uses Accounting Standards Codification ("ASC") 740-10, "*Accounting for Uncertainty in Income Taxes*," which creates a single model to address uncertain income tax positions and prescribes the minimum recognition threshold a tax position is required to meet for recognition in the financial statements. The Company did not recognize any interest or penalties related to any unrecognized tax position during the years ended December 31, 2016 and 2015.

The Company files a consolidated federal income tax return in the United States and state tax returns in the jurisdictions in which it operates.

Stock-Based Compensation

ASC 718-10, "*Accounting for Stock-Based Compensation*", requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statement of operations.

Stock-based compensation expense recognized under ASC 718-10 for the years ended December 31, 2016 and 2015 was \$48,700, and \$61,532, which consists of stock-based compensation expense related to employee and director stock option issuances.

Loss Per Share

Basic loss per share is calculated based on the weighted average number of common shares outstanding during each period. Diluted loss per share considers shares issuable upon exercise of outstanding stock options that have exercise or conversion prices below the market value of the Company's common stock. At December 31, 2016 and 2015, stock options pertaining to 24,000 and 367,000 shares of common stock have been excluded from the computation of diluted earnings per share because the Company is in a net loss position and their effect would be anti-dilutive.

Concentrations of Credit Risk

The Company maintains its cash in financial institutions selected by management based upon their assessment of the financial stability of the institution. Balances periodically exceed the federal depository insurance limit; however, the Company has not experienced any losses on deposits.

Revenue and Cost Recognition

Revenues from services provided are recognized when all of the following criteria have been met: (1) evidence of an arrangement exists, (2) the service has been provided to the customer, (3) the price is fixed or determinable and (4) collectability is reasonably assured.

Cost of revenue includes direct labor, supplies, and freight and is recognized as revenue is earned.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies, continued

Revenue and Cost Recognition, continued

The Company has received contracts from US government entities and others for research and development related to the technology for the VASMIR ® engine and associated technologies. These projects have been recorded as other income on the statement of operations. During the years ended December 31, 2016 and 2015, the Company recorded \$3,273,017 and \$1,738,187, respectively, of other income related to these projects.

Research and Development

Research and development projects and costs are expensed as incurred. These costs consist of direct costs associated with the design of new products. Research and development expenses incurred during the years ended December 31, 2016 and 2015, were \$1,147,692 and \$695,053, respectively.

Fair Value of Financial Instruments

Fair value estimates of financial instruments are based on relevant market information and may be subjective in nature and involve uncertainties and matters of significant judgment. The Company believes that the carrying value of its assets and liabilities approximates the fair value of such items. The Company does not hold or issue financial instruments for trading purposes.

The Company adheres to ASC 820 and includes fair value information in the notes to its consolidated financial statements when the fair value of its financial instruments is different from the book value. When the book value approximates fair value, no additional disclosure is made.

Recently Issued Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ASU No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. For public business entities, the amendments are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period.

ASU 2015-14, Revenue from Contracts with Customer, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2015-14 is recognition of revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2015-14 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required than under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2018, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2015-14 recognized at the date of adoption (which includes additional footnote disclosures). Management is currently evaluating the future impact of the pending adoption of ASU 2015-14 on the consolidated and combined financial statements and have not yet determined the method under which the standard will be adopted in 2019.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Going Concern

Since its inception, the Company has not generated significant revenue from core operations and, accordingly, it has experienced recurring net losses and negative cash flows from operating activities. During the years ended December 31, 2016 and 2015 the Company had net losses of \$104,001, and \$617,599, respectively. The Company reported net cash provided by operating activities of \$134,490 at December 31, 2016 and reported cash used in operating activities of \$647,132, at December 31, 2015. The Company's challenges as a research and development company are further evidenced by its working capital deficiency that was \$2,289,561 and \$1,923,370, at December 31, 2016, and 2015, respectively. In addition to operational cash flow and financial challenges, investing activities required cash of \$174,549, and \$179,600, during the years ended December 31, 2016, and 2015. These factors raise a substantial doubt about the Company's ability to continue as a going concern.

Historically, the Company has financed its operations using sales of its common stock and preferred stock and the issuance of convertible debentures to a related party. The Company used \$4,247 in net cash from financing activities for the year ended December 31, 2016 and generated net cash from financing activities of \$1,053,401 for the year ended December 31, 2015. The Company has received contracts from government entities and others that contribute to the Company's strategic initiatives, as described in the Revenue and Cost Recognition section of Note 1 Summary of Significant Accounting Policies of this report. These have resulted in additional sources of income of \$3,273,017 and \$1,738,187 recorded as other income on the statement of operations for the years ended December 31, 2016 and 2015, respectively. The Company expects to continue to be able to source additional projects and income from these entities in the upcoming year.

Management's primary focus is raising the funds necessary to fully implement the Company's business plan. The Company's long-term viability depends on its ability to obtain adequate equity or debt funding to meet current commitments and fund the continuation of its business operations. Ultimately, the Company must achieve adequate profitability and cash flows from operations to sustain its operations. There can be no assurance that management will be able to secure the funding for its existing commitments and continued operations.

3. Accounts Receivable

Accounts Receivable, at December 31, 2016 and 2015, were \$15,478 and \$34,989, respectively, and relate to various research project contracts and revenue from speaking and consulting engagements.

4. Other Assets

Other assets, at December 31, 2016 and 2015, was comprised of the following:

	<u>2016</u>	<u>2015</u>
Deposits	\$ 37,434	\$ 37,434
License	<u>22,500</u>	<u>25,000</u>
Total	<u>\$ 59,934</u>	<u>\$ 62,434</u>

The license included in other assets is an intangible asset obtained from a United States governmental agency that allows the Company to use certain technologies in the development of its advanced plasma rocket propulsion technology. The license was acquired during 2006 for \$50,000 and is being amortized over its 20 year contractual life. The Company recorded amortization expense of \$ 2,500 during each of the years ended December 31, 2016 and 2015.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Property and Equipment

Property and equipment at December 31, 2016 and 2015, and related activity for the years then ended, were as follows:

December 31, 2016

<u>Description</u>	<u>2015</u>	<u>Additions/ Transfers in</u>	<u>Retirements/ Transfers out</u>	<u>2016</u>
Computer and software	\$ 650,746	\$ 11,700	\$ (1,932)	\$ 660,514
Laboratory equipment	3,881,723	144,440	-	4,026,163
Machine shop equipment	90,259	12,137	-	102,396
Leasehold improvements	1,570,963	-	-	1,570,963
Solar power equipment	-	200,000	-	200,000
Other	138,956	6,272	-	145,228
	6,332,647	374,549	(1,932)	6,705,264
Less accumulated depreciation	<u>(6,147,365)</u>	<u>(99,053)</u>	<u>-</u>	<u>(6,246,418)</u>
Net property and equipment	<u>\$ 185,282</u>	<u>\$ 275,496</u>	<u>\$ (1,932)</u>	<u>\$ 458,846</u>

December 31, 2015

<u>Description</u>	<u>2014</u>	<u>Additions/ Transfers in</u>	<u>Retirements/ Transfers out</u>	<u>2015</u>
Computer and software	\$ 574,068	\$ 76,678	\$ -	\$ 650,746
Laboratory equipment	3,830,773	50,950	-	3,881,723
Machine shop equipment	38,287	51,972	-	90,259
Leasehold improvements	1,570,963	-	-	1,570,963
Other	138,956	-	-	138,956
	6,151,843	179,600	-	6,332,647
Less accumulated depreciation	<u>(6,061,502)</u>	<u>(44,226)</u>	<u>-</u>	<u>(6,147,365)</u>
Net property and equipment	<u>\$ 90,341</u>	<u>\$ (44,226)</u>	<u>\$ -</u>	<u>\$ 185,282</u>

Depreciation and amortization expense of \$99,053, and \$44,226 was recognized during the years ended December 31, 2016 and 2015.

6. Accrued Liabilities

Accrued liabilities, at December 31, 2016 and 2015, was comprised of the following:

	<u>2016</u>	<u>2015</u>
Deferred salaries	\$ 607,628	\$ 607,628
Other wages payable	1,100	1,060
Payroll taxes and benefits	127,489	122,639
Legal contingency	150,000	150,000
Other	-	144
	<u>\$ 886,217</u>	<u>\$ 881,471</u>

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Notes Payable and Long-Term Debt

Line of Credit, Related Party

At December 31, 2016 and 2015, the Company had a \$408,000 line of credit with a related party vendor, owned by a member of the Company's board of directors. The line of credit and related accrued interest of \$139,790 and \$122,250, at December 31, 2016 and 2015, are due on demand. The interest rate on this line of credit is the current "prime" interest rate, 3.25% at December 31, 2016 and 2015.

Notes Payable

The Company had the following notes payable at December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Note payable to a bank, bearing interest at a fixed rate of 9% per year and due in total monthly payments of \$2,500, including interest, through March 2017, at which date, a balloon payment for the remaining principal balance of \$229,000 is due. The note was originally collateralized by certain customer contracts which ended in December 2014. At December 31, 2016 and 2015, the note was uncollateralized.	\$ 231,048	\$ 239,541
Demand note payable to a member of the Company's Board of Directors, bearing interest at a fixed rate of 3.25% per year and uncollateralized. The note holder has the right to convert any outstanding principal and or interest into shares of common stock of the Company at the estimated market price at the date of conversion. Accrued interest on this note was \$34,281 and \$18,208 at December 31, 2016 and 2015, respectively.	500,000	500,000
Note payable to a solar panel equipment manufacturer, bearing interest at a fixed rate of 9.50% per year, with principal and interest of \$2,588 due in monthly installments until April 2026. The loan is collateralized with the purchased equipment. The Company has the option to opt out of the purchase agreement with no penalties or fees if proper four-month notice is given to the equipment manufacturer. As of December 31, 2016 the Company does not anticipate opting out of the purchase agreement.	<u>191,736</u>	<u>-</u>
	922,784	739,541
Less current maturities	<u>(743,642)</u>	<u>(508,063)</u>
Total long-term debt, net of current maturities	<u>\$ 179,142</u>	<u>\$ 231,478</u>

At December 31, 2016, future minimum principal payments remaining under our notes payable are as follows:

<u>Year</u>	
2017	\$ 743,642
2018	14,746
2019	16,209
2020	17,818
2021 and after	<u>130,369</u>
	<u>\$ 922,784</u>

The Company's weighted average interest rate on outstanding short-term debt obligations for the years ended December 31, 2016 and 2015 was 5.16% and 5.84%, respectively. The Company's weighted average effective rate on outstanding short-term debt obligations for the years ended December 31, 2016 and 2015 was 6.16% and 5.27%, respectively.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Stock Incentive Plan

On September 9, 2016 the Company adopted the Ad Astra Rocket Company 2016 Stock Incentive Plan (the "Plan"). A total of 2,000,000 shares of common stock are reserved for issuance under the Plan. The purpose of the Plan is to promote continued service by certain key employees, non-employee members of the Board of Directors, consultants and other independent advisors, by providing the opportunity to acquire an interest in the Company.

The following table summarizes certain information relative to stock options issued pursuant to the Plan:

	<u>2016 Stock Incentive Plan</u>	
	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>
Outstanding, December 31, 2014	407,300	\$ 3.31
Granted	<u>55,000</u>	<u>6.00</u>
Outstanding, December 31, 2015	462,300	3.31
Exercised	(3,000)	(4.17)
Forfeited/cancelled	<u>(288,750)</u>	<u>(1.73)</u>
Outstanding, December 31, 2016	<u>170,550</u>	<u>6.84</u>
Exercisable, December 31, 2016	<u>133,050</u>	<u>\$ 7.07</u>

The weighted-average remaining life and weighted-average exercise price of outstanding options at December 31, 2016 were 4.06 years and \$6.84. The exercise prices for outstanding options ranged from \$4.17 to \$12.00 at December 31, 2016, and information relating to such options follows:

<u>Range of Exercise</u>	<u>Stock Options Outstanding</u>	<u>Stock Options Exercisable</u>	<u>Weighted Average Remaining Contract Life</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Exercise Price of Options Exercisable</u>
\$4.17	24,000	24,000	0.4 years	\$ 4.17	\$ 4.17
\$4.18 - \$6.67	112,750	75,250	4.8 years	\$ 6.37	\$ 6.55
\$6.68 - \$12.00	<u>33,800</u>	<u>32,800</u>	4.1 years	\$ 10.30	\$ 10.30
	<u>170,550</u>	<u>133,050</u>			

During the year ended December 31, 2016, the Company did not grant any options. The Company used the Black-Scholes-Merton option pricing model and the following assumptions to calculate weighted-average estimated fair value of the stock options granted under the Plan for the year ended December 31 2015:

	<u>2016</u>	<u>2015</u>
Expected volatility	N/A	48.0%
Risk free interest rate	N/A	2.0%
Expected life	N/A	10 yrs
Weighted average fair value	N/A	\$3.60

During the years ended December 31, 2015, the Company granted 55,000 options. The fair value of options expensed under the Plan was \$48,700, and \$61,533 during the years ended December 31, 2016 and 2015, respectively.

As of December 31, 2016, there was \$143,261 of unrecognized expense related to non-vested share-based compensation arrangements.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Related Party Transactions

At December 31, 2016 and 2015, accounts payable related party of \$279,656 were related to system integration services performed by a company owned by a member of the Company's board of directors..

During the years ended December 31, 2016 and 2015, the Company leased its Costa Rica laboratory and warehouse from an investment fund and recognized lease expense of \$83,250 and \$88,000, respectively. The investment fund is a related party because it is controlled by an affiliate of the Company's investment banker and shareholder ("Aldesa"). At December 31, 2016 and 2015, there was no outstanding balance due to this affiliate under the lease agreement. During the years ended December 31, 2016 and 2015, the Company paid Aldesa commissions of \$0 and \$1,443, respectively. Aldesa earned the commissions from sale of 12,028 shares of the Company's common stock for net proceeds of \$70,725 during the year ended December 31, 2015.

10. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax reporting purposes. For the years ended December 31, 2016 and 2015, there were no provisions for income taxes and deferred tax assets have been entirely offset by a valuation allowance, due to the Company's unlikely realization based on its recurring net losses.

Significant components of the Company's deferred tax assets and liabilities at December 31, 2016 and 2015 were as follows:

	<u>2016</u>	<u>2015</u>
Deferred tax assets:		
Net operating loss carry-forwards	\$ 9,495,977	\$ 9,604,441
Non-deductible accruals	438,675	460,332
Basis difference in property and equipment	<u>166,836</u>	<u>173,666</u>
Total deferred tax assets	<u>10,104,488</u>	<u>10,238,439</u>
Valuation allowance	<u>(10,104,488)</u>	<u>(10,238,439)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

The difference between the income tax benefit in the accompanying statements of operations and the amount that would result if the U.S. Federal statutory rate of 34% were applied to pre-tax loss for the years ended December 31, 2016 and 2015 is as follows:

	<u>2016</u>		<u>2015</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Benefit for income tax at federal statutory rate	\$ (35,361)	(34.0)	\$ (209,983)	(34.0)
Change in valuation allowance	133,951	129.0	(6,658)	(1.1)
Compensatory stock option grants	16,558	16.0	20,921	3.4
Tax accrual to return adjustments	<u>(115,148)</u>	<u>(111.0)</u>	<u>195,720</u>	<u>31.7</u>
	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>	<u>-</u>

At December 31, 2016, for United States federal income tax reporting purposes, the Company has approximately \$27,929,345 of unused net operating losses ("NOLs") available for carry-forward to future years. The benefit from carry-forward of such NOLs will expire at various dates through December 31, 2036. Because tax laws limit the time during which NOL carry-forwards may be applied against future taxable income, the Company may be unable to take full advantage of its NOLs for federal income tax purposes should the Company generate taxable income. Further, the benefit from utilization of NOL carry-forwards could be subject to limitations due to material ownership changes that may or may not occur in the Company. Based on such limitations, the Company has significant NOL's for which realization of tax benefits is uncertain and thus has recorded a valuation allowance equal to 100% of its unused NOLs as of December 31, 2016.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Stockholders' Equity (Deficit)

Common Stock

The Company's Certificate of Incorporation authorizes issuance of 75,000,000 shares of \$0.01 par value common stock. At December 31, 2016 and 2015, the Company had 21,000,713 and 20,997,713 shares of common stock issued and outstanding, respectively. The Board of Directors may issue any authorized but unissued shares of common stock at prices and under other terms approved by the Board. The Company has not entered into any agreements with common stockholders that provide such stockholders with preferential economic rights not available to all holders of such class of common stock.

Holders of Common Stock are entitled to one vote for each share held and have no preemptive or similar right to subscribe for, or to purchase, any shares of common stock or other securities to be issued by the Company in the future. Holders of shares of Common Stock have no exchange or conversion rights and the shares are not subject to redemption.

The Company is authorized by the Superintendencia General de Valores de Costa Rica ("Sugeval") to undertake Restricted Public Offerings ("RPO") of its Common Stock. These offerings are conducted under Costa Rican law outside of the United States of America. The Company has approved the issuance of up to 1,000,000 shares of Common Stock pursuant to the RPO.

During the year ended December 31, 2016, the Company sold 3,000 shares of Common Stock pursuant to the exercise of options under the Ad Astra Rocket Company 2016 option plan at a price of \$4.17 per share resulting in cash proceeds of \$12,510. The Company recorded no issuance costs related to this exercise.

During the year ended December 31, 2015, the Company sold 12,028 shares of Common Stock pursuant to the RPO at a price of \$6.00, per share resulting in net cash proceeds of \$70,725. The Company recorded issuance costs related to these issuances totaling \$1,443.

During the year ended December 31, 2015, the Company also sold 150,000 shares of Common Stock through private placements at a price of \$5.00, per share resulting in cash proceeds of \$750,000. The Company had no issuance costs related to these issuances.

Preferred Stock

The Company has 10,000 authorized shares of \$0.01 par value Preferred Stock. The Preferred Stock may be issued in series, with designations, rights, preferences, and limitations determined by the Board of Directors.

Series A Preferred Stock

At December 31, 2016 and 2015, the Company had 2,200 shares authorized and 369 shares issued and outstanding of \$0.01 par value Series A preferred stock ("Series A"). Series A has a liquidation preference equal to the original purchase price and does not pay a mandatory dividend. Series A is convertible into Common Stock any time at the option of the holder at a price determined by dividing the Series A original issue price by the Series A conversion price in effect at the time of conversion. The Series A conversion price is equal to the original issue price per share divided by 3,000. The Company has the right to redeem Series A for cash at any time after the five year anniversary date of the issuance at a redemption price calculated by multiplying the Series A original issue price by one plus the Prime Rate (as reported by Bloomberg, L.P.) on the date of redemption times the number of years from the applicable Series A original issue date until the date of such calculation with a partial year being expressed by dividing the number of days which have passed since the most recent anniversary by 365, plus all declared but unpaid dividends.

During the years ended December 31, 2016 and 2015 the Company did not issue any shares of Series A Preferred Stock.

At December 31, 2016 and 2015, there were no accumulated, undeclared dividends.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Stockholders' Equity (Deficit)

Series C Preferred Stock

At December 31, 2016 and 2015, the Company had 1,000 shares authorized and 26 issued and outstanding, of \$0.01 par value Series C preferred stock ("Series C"). Series C has a liquidation preference equal to the original purchase price and does not pay a mandatory dividend. The Series C is convertible by the holder into Common Stock within 15 days of notice of redemption from the Company at a price determined by dividing the Series C original issue price by the Series C conversion price in effect at the time of conversion.

The Series C conversion price is equal to the original issue price per share divided by 3,000. The Company has the right to redeem Series C for cash at any time after issuance with a twenty-day written notice at a redemption price equal to the original issue price, plus all declared but unpaid dividends. Series C stock become mandatorily convertible to common shares at a conversion rate of 3,000 common shares for each Series C share if Company closes an underwritten public offering and sale of its common stock pursuant to an effective registration statement under the Securities Act of 1933, as amended.

During the years ended December 31, 2016 and 2015, the Company did not issue any shares of Series C Preferred Stock.

At December 31, 2016 and 2015, there were no accumulated and undeclared dividends.

12. Commitments

Operating Leases

In November of 2015, the Company negotiated a new lease agreement with its related party for office and laboratory space in Liberia, Costa Rica. The term of the agreement is for thirty-six months with base rent of approximately \$7,300 per month.

In August 2012, the Company renewed its lease agreement for office and laboratory space in Webster, Texas. The term of the agreement is for thirty-six months with a one-time option to extend the lease an additional two years. In July 2015, the Company exercised its one time option to extend the lease for an additional two years, through July 2017 with base rent of approximately \$15,000 per month plus a pro-rata share of operating expenses.

Rent expense for the years ended December 31, 2016 and 2015 totaled \$329,852, and \$309,446.

Minimum annual rentals under non-cancelable operating leases of more than one year in duration are as follows:

<u>Year</u>	<u>Annual Expense</u>
2017	191,060
2018	<u>73,202</u>
	<u>\$ 264,262</u>

13. Contingencies

From time to time, the Company may be involved in various claims and legal actions arising in the ordinary course of business. Management, along with the assistance of legal counsel, will determine the ultimate disposition and potential impact of these matters on the Company's financial condition, liquidity or results from operations. As of December 31, 2016, the Company is involved in a regulatory tax matter with the taxing authorities in Costa Rica. The taxing authorities have claimed the Company owed taxes and penalties related to ancillary income earned. As a result of this claim, the Company recorded a current liability of \$150,000 to cover the expected back taxes, penalties and legal representation for the matter.

AD ASTRA ROCKET COMPANY and SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Subsequent Events

On March 1, 2017 the Company refinanced its note payable with a bank which came due on that date. The new note payable, with a separate financial institution, is a 5 year note, bearing interest at a fixed rate of 3% per year payable in monthly payments of \$2,236, including interest, through March 2022, at which date, a balloon payment for the remaining principal balance of \$126,075 is due. The note is guaranteed by an executive of the Company.

Subsequent events have been evaluated through March 10, 2017 which is the date the consolidated financial statements were available to be issued.

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