

**AD ASTRA ROCKET COMPANY
AND SUBSIDIARIES
(A DEVELOPMENT STAGE
ENTERPRISE)**

**CONSOLIDATED FINANCIAL STATEMENTS
as of and for the years ended
December 31, 2011 and 2010 and for the period
from Inception, July 15, 2005, to December 31, 2011**

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
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Report of Independent Accountants

To the Board of Directors
Ad Astra Rocket Company and Subsidiaries

We have audited the accompanying consolidated balance sheets of Ad Astra Rocket Company and Subsidiaries (the "Company") (a development stage enterprise) as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders' (deficit)/equity and cash flows for the years then ended and for the period from inception, July 15, 2005, to December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2011 and 2010 and the results of its operations and cash flows for the years then ended and for the period from inception, July 15, 2005, to December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 15 to the consolidated financial statements, the Company has suffered recurring net losses, working capital deficiencies 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 regarding this matter are also discussed in Note 15. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Ham, Langston & Brezina, L.L.P.

Houston, Texas
March 15, 2012

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED BALANCE SHEETS
December 31, 2011 and 2010

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
Current assets:		
Cash	\$ 14,822	\$ 383,285
Accounts receivable, net	18,139	22,181
Prepaid expenses	<u>12,701</u>	<u>10,518</u>
Total current assets	<u>45,662</u>	<u>415,984</u>
Other assets	71,443	68,197
Property and equipment, net	933,243	2,015,271
Capital lease assets, net	<u>41,160</u>	<u>73,100</u>
Total assets	<u>\$ 1,091,508</u>	<u>\$ 2,572,552</u>
 <u>LIABILITIES AND STOCKHOLDERS' (DEFICIT)/EQUITY</u>		
Current liabilities:		
Line of credit, related party	\$ 408,000	\$ 690,000
Note payable	-	7,359
Notes payable, related party	175,051	-
Short-term portion deferred lease expense	18,442	31,584
Short-term portion capital lease obligation	29,852	30,468
Bonds payable	100,000	-
Accounts payable	553,896	261,268
Accounts payable, related party	200,671	325,893
Accrued liabilities	324,197	567,218
Interest payable to related party	<u>56,795</u>	<u>34,191</u>
Total current liabilities	1,866,904	1,947,981
Long-term liabilities:		
Long-term portion deferred lease expense	-	18,442
Long-term portion capital lease obligation	<u>10,632</u>	<u>40,484</u>
Total long-term liabilities	<u>10,632</u>	<u>58,926</u>
Total liabilities	<u>1,877,536</u>	<u>2,006,907</u>
Commitments and contingencies		
Stockholders' (deficit)/ equity:		
Preferred stock:		
Series A, par value \$0.01, 2,200 shares authorized; 369 shares issued and outstanding	4	4
Series B, par value \$0.01, 1,000 shares authorized; none issued or outstanding	-	-
Series C, par value \$0.01, 1,000 shares authorized; 25 issued and outstanding	-	-
Common stock par value \$0.01, 75,000,000 shares authorized; 20,251,645 and 20,078,052 shares issued and outstanding	202,517	200,781
Additional paid-in capital	27,863,402	24,939,386
Losses accumulated during development stage	<u>(28,851,951)</u>	<u>(24,574,526)</u>
Total stockholders' (deficit)/equity	<u>(786,028)</u>	<u>565,645</u>
Total liabilities and stockholders' (deficit)/equity	<u>\$ 1,091,508</u>	<u>\$ 2,572,552</u>

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

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF OPERATIONS
for the years ended December 31, 2011 and 2010 and for the
period from inception, July 15, 2005, to December 31, 2011

	<u>Year Ended</u> <u>December 31, 2011</u>	<u>Year Ended</u> <u>December 31, 2010</u>	<u>Period from</u> <u>Inception,</u> <u>July 15, 2005, to</u> <u>December 31, 2011</u>
General and administrative expenses:			
Payroll expense	\$ 2,287,649	\$ 2,293,220	\$ 14,508,696
Professional fees	52,633	116,676	1,513,055
Other general and administrative expenses	<u>2,347,158</u>	<u>2,663,351</u>	<u>13,285,573</u>
Total general and administrative expenses	4,687,440	5,073,247	29,307,324
Other income (expense):			
Interest income	83	360	324,065
Interest expense	(25,657)	(47,818)	(1,130,359)
Other income	<u>435,589</u>	<u>297,017</u>	<u>1,261,667</u>
Total other income (expense), net	<u>410,015</u>	<u>249,559</u>	<u>455,373</u>
Net loss before provision for income taxes	(4,277,425)	(4,823,688)	(28,851,951)
Provision for income taxes	<u>-</u>	<u>-</u>	<u>-</u>
Net loss	<u>\$ (4,277,425)</u>	<u>\$ (4,823,688)</u>	<u>\$ (28,851,951)</u>
Basic and diluted loss per share	<u>\$ (.21)</u>	<u>\$ (.24)</u>	<u>\$ (1.75)</u>
Basic and diluted weighted-average shares outstanding	<u>20,164,163</u>	<u>20,131,806</u>	<u>16,464,643</u>

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

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT)/EQUITY
for the years ended December 31, 2011 and 2010 and for the
period from inception, July 15, 2005, to December 31, 2011

	Preferred Stock				Common Stock				Stock Subscription Receivable	Additional Paid-In Capital	Losses Accumulated During Development Stage	Total Stockholders' (Deficit)/Equity
	Class A		Class B		Class A		Class B					
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balance at inception, July 15, 2005	-	\$ -		\$ -	-	\$ -	-	\$ -	\$ -	\$ -	\$ -	\$ -
Common stock issued for cash	-	-		-	-	-	3,500	4	-	49,996	-	50,000
Additional capital contributed by stockholder	-	-	-	-	-	-	-	-	-	2,000	-	2,000
Common stock issued for services	-	-	-	-	-	-	762	-	-	10,885	-	10,885
Net loss	-	-	-	-	-	-	-	-	-	-	(881,852)	(881,852)
Balance at December 31, 2005	-	-	-	-	-	-	4,262	4	-	62,881	(881,852)	(818,967)
Common stock issued for cash	-	-	-	-	-	-	100	1	-	499,999	-	500,000
Preferred stock issued for cash	809	1	-	-	-	-	-	-	-	4,044,999	-	4,045,000
Preferred stock subscribed for	111	-	-	-	-	-	-	-	(1,387,500)	1,387,500	-	-
Compensatory element of stock option grants	-	-	-	-	-	-	-	-	-	312,764	-	312,764
Net loss	-	-	-	-	-	-	-	-	-	-	(3,489,603)	(3,489,603)
Balance at December 31, 2006	920	1	-	-	-	-	4,362	5	(1,387,500)	6,308,143	(4,371,455)	549,194
Preferred stock issued for cash	198	-	-	-	-	-	-	-	-	2,741,302	-	2,741,302
Payment for preferred stock Subscription	-	-	-	-	-	-	-	-	1,387,500	-	-	1,387,500
Compensatory element of stock option grants	-	-	-	-	-	-	-	-	-	30,987	-	30,987
Net loss	-	-	-	-	-	-	-	-	-	-	(4,713,110)	(4,713,110)
Balance at December 31, 2007	1,118	1	-	-	-	-	4,362	5	-	9,080,432	(9,084,565)	(4,127)

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

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT)/EQUITY
for the years ended December 31, 2011 and 2010 and for the
period from inception, July 15, 2005, to December 31, 2011, continued

	Preferred Stock				Common Stock				Stock Subscription Receivable	Additional Paid-In Capital	Losses Accumulated During Development Stage	Total Stockholders' (Deficit)/Equity
	Class A		Class B		Class A		Class B					
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balance at December 31, 2007	1,118	1	-	-	-	-	4,362	5	-	9,080,432	(9,084,565)	(4,127)
Common stock issued for cash	-	-	-	-	71	-	3,000	3	-	1,419,997	-	1,420,000
Preferred stock issued for cash	68	-	-	-	-	-	-	-	-	1,216,000	-	1,216,000
Preferred stock converted to common stock	(857)	-	-	-	857	-	-	-	-	-	-	-
Stock dividends, net of shares exchanged	-	-	-	-	2,780,072	2,781	13,081,638	13,081	-	(15,862)	-	-
Compensatory element of stock option grants	-	-	-	-	-	-	-	-	-	140,388	-	140,388
Net loss	-	-	-	-	-	-	-	-	-	-	(5,704,402)	(5,704,402)
Balance at December 31, 2008	329	1	-	-	2,781,000	2,781	13,089,000	13,089	-	11,840,955	(14,788,967)	\$ (2,932,141)
Common stock issued for cash	-	-	-	-	160,548	160	3,000	3	-	1,114,984	-	1,115,147
Preferred stock issued for cash	23	-	36	-	-	-	-	-	-	1,195,020	-	1,195,020
Compensatory element of stock option grants	-	-	-	-	-	-	-	-	-	86,219	-	86,219
Net loss	-	-	-	-	-	-	-	-	-	-	(4,961,871)	(4,961,871)
Balance at December 31, 2009	352	1	36	-	2,941,548	2,941	13,092,000	13,092	-	14,237,178	(19,750,838)	(5,497,626)
Consolidation of Class A and Class B common stock	-	-	-	-	(2,941,548)	(2,941)	2,941,548	2,941	-	-	-	-
Common stock issued for cash, net of issuance costs of \$319,396	-	-	-	-	-	-	180,504	1,805	-	1,446,071	-	1,447,876
Common stock issued for conversion of convertible debenture, related party	-	-	-	-	-	-	3,546,000	3,546	-	7,013,280	-	7,016,826
Preferred stock issued for conversion of line of credit, related party	17	-	-	-	-	-	-	-	-	510,000	-	510,000
Change in par value of stock common stock	-	-	-	-	-	-	-	176,217	-	(176,217)	-	-
Preferred stock issued for cash, net of issuance costs of \$176,586	-	-	70	-	-	-	-	-	-	1,749,113	-	1,749,113
Preferred stock converted to common stock	-	-	(106)	-	-	-	318,000	3,180	-	(3,180)	-	-
Change in par value of preferred stock	-	3	-	-	-	-	-	-	-	(3)	-	-
Compensatory element of stock option grants	-	-	-	-	-	-	-	-	-	163,144	-	163,144
Net loss	-	-	-	-	-	-	-	-	-	-	(4,823,688)	(4,823,688)
Balance as of December 31, 2010	369	4	-	-	-	-	20,078,052	200,781	-	24,939,386	24,574,526)	565,645

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

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIT)/EQUITY
for the years ended December 31, 2011 and 2010 and for the
period from inception, July 15, 2005, to December 31, 2011, continued

	<u>Preferred Stock</u>		<u>Class B</u>		<u>Class C</u>		<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Losses Accumulated During Development Stage</u>	<u>Total Stockholders' Deficit</u>
	<u>Class A</u>	<u>Class B</u>	<u>Class B</u>	<u>Class B</u>	<u>Class C</u>	<u>Class C</u>	<u>Class C</u>	<u>Class C</u>			
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>			
Common stock issued for cash, net of issuance costs of \$234,163	-	-	-	-	-	-	172,093	1,721	1,756,318	-	1,758,039
Common stock issued for conversion of vendor payable, related party	-	-	-	-	-	-	1,500	15	17,985	-	18,000
Preferred stock issued for conversion of vendor payable, related party	-	-	-	-	3	-	-	-	108,000	-	108,000
Preferred stock issued for conversion of line of credit, related party	-	-	-	-	22	-	-	-	792,000	-	792,000
Compensatory element of stock option grants.	-	-	-	-	-	-	-	-	249,713	-	249,713
Net loss	-	-	-	-	-	-	-	-	-	(4,277,425)	(4,277,425)
Balance as of December 31, 2011	<u>369</u>	<u>\$ 4</u>	<u>-</u>	<u>-</u>	<u>25</u>	<u>\$ -</u>	<u>20,251,645</u>	<u>\$ 202,517</u>	<u>\$27,863,402</u>	<u>\$(28,851,951)</u>	<u>\$ (786,028)</u>

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

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the years ended December 31, 2011 and 2010 and for the
period from inception, July 15, 2005, to December 31, 2011

	<u>Year Ended</u> <u>December 31, 2011</u>	<u>Year Ended</u> <u>December 31, 2010</u>	<u>Period from</u> <u>Inception</u> <u>July 15, 2005 to</u> <u>December 31, 2011</u>
Cash flows used in operating activities:			
Net loss	\$ (4,277,425)	\$ (4,823,688)	\$ (28,851,951)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization expense	1,127,880	1,198,186	5,342,004
Compensatory element of stock option grants	249,713	163,144	983,215
Common stock issued for services	-	-	10,885
Deferred salary forgiven	(143,878)	-	(143,878)
Deferred rent expense	(31,584)	(31,584)	18,442
Changes in operating assets and liabilities:			
Accounts receivable	4,042	(17,816)	(18,140)
Prepaid expenses	(2,183)	4,938	(12,702)
Other assets	(3,246)	5,016	(100)
Accounts payable and accrued liabilities	383,086	(239,314)	846,625
Accounts payable, related party	778	145,893	200,671
Interest payable, related party	22,604	43,089	1,062,738
Deferred salary	(189,601)	197,914	332,227
Net cash used in operating activities	<u>(2,859,814)</u>	<u>(3,354,222)</u>	<u>(20,229,964)</u>
Cash flows used in investing activities:			
Purchases of equipment	(13,912)	(96,394)	(6,253,372)
Proceeds from disposal of fixed assets	<u>-</u>	<u>-</u>	<u>25,344</u>
Net cash used in investing activities	<u>(13,912)</u>	<u>(96,394)</u>	<u>(6,228,028)</u>
Cash flows from financing activities:			
Payments on capital lease obligation	(30,468)	(29,055)	(119,235)
Payments on royalty note payable	(7,359)	(12,641)	(20,000)
Payments on notes payable, related party	(21,949)	-	(21,949)
Proceeds from:			
Line of credit	510,000	600,000	1,710,000
Notes payable, related party	197,000	-	197,000
Issuance of convertible debenture	-	-	6,000,000
Capital contribution by stockholder	-	-	2,000
Issuance of bonds payable	100,000	-	100,000
Stock subscription receivable	-	-	1,387,500
Issuance of common stock, net of issuance costs	1,758,039	1,447,876	6,291,062
Issuance of preferred stock, net of issuance costs	<u>-</u>	<u>1,749,114</u>	<u>10,946,436</u>
Net cash provided by financing activities	<u>2,505,263</u>	<u>3,755,294</u>	<u>26,472,814</u>
Net (decrease)/increase in cash and cash equivalents	(368,463)	304,678	14,822
Cash and cash equivalents, beginning of period	<u>383,285</u>	<u>78,607</u>	<u>-</u>
Cash and cash equivalents, end of period	<u>\$ 14,822</u>	<u>\$ 383,285</u>	<u>\$ 14,822</u>

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

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Ad Astra Rocket Company and Subsidiaries (the "Company" or "AARC") is a development stage enterprise incorporated on January 14, 2005 and officially organized on July 15, 2005 in Houston, Texas. The Company is considered a development stage enterprise because it has not yet, nor expects to generate significant revenue from sale of its products, during its development stage, and has devoted substantially all of its efforts in raising capital to develop its products to bring to market. The Company is dedicated to the research and development of advanced plasma rocket propulsion technology and is continuing with development of the Variable Specific Impulse Magnetoplasma Rocket ("VASIMR[®]") and its associated technologies. The Company is involved in furthering the technology for the usage of plasma for other diversified areas including power generation, hydrogen technology, plasma diagnostics and disposal of medical waste.

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, which is dormant as of December 31, 2011 and 2010. The consolidated financial statements also include the accounts of the Company's indirect, wholly owned subsidiary, which was dormant as of December 31, 2011 and 2010, 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 subsidiaries are determined using the United States of America Dollar ("USD") as the functional currency.

Cash and Cash Equivalents

For purposes of the statement of 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 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 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.

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
Capital lease equipment	5

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.

Capital Lease Assets

Leased property meeting certain criteria is capitalized and the present value of the related lease payment is recorded as a liability. Amortization of capitalized assets is computed on the straight-line method over the term of the respective lease.

Continued

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Impairment of Long-Lived Assets

In the event that 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. Management has determined no impairment of long-lived assets existed as of December 31, 2011 and 2010.

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 amounts at year-end. The Company provides a valuation allowance to reduce deferred tax assets to their net realizable value.

The Company follows the guidance promulgated by Accounting Standards Codification ("ASC") 740-10, *Accounting for Uncertainty in Income Taxes*, which creates a single model to address uncertainty in income tax positions and prescribes the minimum recognition threshold a taxation is required to meet before recognized 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, 2011 and 2010.

The Company files a separate federal income tax return in the United States and state tax returns where applicable. With few exceptions, the Company is no longer subject to United States federal income tax or state income tax examinations for years before 2008.

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.

The Company follows the guidance promulgated by ASC 718-10. In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of ASC 718-10. Stock-based compensation expense recognized under ASC 718-10 for the years ended December 31, 2011 and 2010 and for the period from inception, July 15, 2005, to December 31, 2011 was \$249,713, \$163,144, and \$983,215, respectively, which consists of stock-based compensation expense related to employee and director stock options issuances.

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.

Research and Development

Costs of research and development projects are expensed as incurred. These costs consist of direct costs associated with the design of new products. Research and development expenses for the years ended December 31, 2011, and 2010 and for the period from inception, July 15, 2005, to December 31, 2011 were \$1,396,062, \$1,678,966, and \$9,147,655.

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.

Continued

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE ENTERPRISE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies, continued

Fair Value of Financial Instruments, continued

The Company adheres to ASC 820 and includes fair value information in the notes to 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.

Loss per Share

The Company calculates loss per share in accordance with ASC 260-10, "Earnings per Share." Basic loss per share is computed by dividing the net loss by the weighted-average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common stock equivalents had been issued and if the additional common shares were dilutive.

The following potential common stock equivalents have been excluded from the computation of diluted net loss per share for the periods presented because the effect would have been anti-dilutive for the years ended December 31, (Options and Warrants typically convert on a one for one basis, see conversion details of the preferred stock stated below for the common stock shares issuable upon conversion):

	<u>2011</u>	<u>2010</u>
Options outstanding under the Company's stock option plan	591,625	614,500
Convertible Series A preferred stock	369	369
Convertible Series C preferred stock	25	-

Series A and Series B preferred stock is convertible into shares of common stock at a conversion price of \$10 and \$12 per share, respectively.

New Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update ("ASU") 2010-06, *Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements*, expanding disclosures about fair value measurements by adding disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements and the transfers between Levels 1, 2 and 3. The new disclosures and clarifications of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosure requirements related to the activity in Level 3 fair value measurements. Those disclosure requirements are effective for fiscal years beginning after December 15, 2010. The Company adopted the new guidance in fiscal 2010, and it did not have an impact on the Company's consolidated financial statements.

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and International Financial Reporting Standards ("IFRS")*. This pronouncement was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between US GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements, particularly for Level 3 fair value measurements. ASU No. 2011-04 is effective for reporting periods beginning after December 15, 2011 with application on a prospective basis. The Company does not anticipate the adoption of this new guidance to have a significant impact on its financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 requires comprehensive income to be reported in either a single statement or in two consecutive statements reporting net income and other comprehensive income. The ASU does not change what is required to be reported in other comprehensive income or the requirement to disclose reclassifications of items from other comprehensive income to net income. In addition, in December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU 2011-12 indefinitely defers the provision in ASU 2011-05 under which entities must

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AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies, continued

present reclassification adjustments out of accumulated other comprehensive income by component in both the statement where net income is presented and the statement where other comprehensive income is presented. ASU 2011-05 is effective for interim and annual periods beginning after December 31, 2011. Early adoption is permitted but full retrospective application is required. The adoption ASU 2011-05 only impacts financial statement presentation; accordingly, it will have no impact on the Company's financial condition, results of operations, or cash flows.

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. ASU No. 2011-11 was issued to provide enhanced disclosures that will enable users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. The amendments under ASU No. 2011-11 require enhanced disclosures by requiring entities to disclose both gross information and net information about both instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and lending arrangements. ASU No. 2011-11 is effective retrospectively for annual periods beginning on or after January 1, 2013, and interim periods within those periods. The Company is evaluating the potential impact of the adoption of this new guidance on its financial statements.

Reclassifications

Certain items in the 2010 consolidated financial statements have been reclassified to conform to the 2011 consolidated financial statements' presentation. The reclassifications have no impact on net loss or stockholders' (deficit)/equity as previously reported.

2. Accounts Receivable

The balance of Accounts Receivable, resulting from various speaking and consulting engagements provided by Company officials, as of December 31, 2011 and 2010 was \$18,139 and \$22,181 respectively. Due to the limited number and valuation of the receivables, a reserve has not been set up for uncollectable accounts.

3. Other Assets

Other assets were comprised of the following at December 31,

	<u>2011</u>	<u>2010</u>
Deposits	\$ 35,017	\$ 30,697
License	35,000	37,500
Other	<u>1,426</u>	<u>-</u>
Total	<u>\$ 71,443</u>	<u>\$ 68,197</u>

The license included in other assets is an intangible asset obtained from a United States of America governmental agency allowing 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 20 years, its contractual life. For the years ended December 31, 2011 and 2010 and the period from inception, July 15, 2005, to December 31, 2011, the Company recorded amortization expense of \$ 2,500, \$2,500 and \$15,000, respectively.

4. Inventory

The Company is still in the development stage; therefore there is no inventory held resulting in no reserves for obsolescence.

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Property and Equipment

Property and equipment were comprised of the following at December 31:

<u>Description</u>	<u>2010</u>	<u>Additions/ Transfers in</u>	<u>Retirements/ Transfers out</u>	<u>2011</u>
Computer and software	\$ 555,801	\$ 13,912	\$ (549)	\$ 569,164
Laboratory equipment	3,829,339	-	(434)	3,828,905
Machine shop equipment	38,287	-	-	38,287
Leasehold improvements	1,570,963	-	-	1,570,963
Other	<u>138,587</u>	<u>-</u>	<u>-</u>	<u>138,587</u>
	6,132,977	13,912	(983)	6,145,906
Less accumulated depreciation	<u>(4,117,706)</u>	<u>(1,094,957)</u>	<u>-</u>	<u>(5,212,663)</u>
Net property and equipment	<u>\$ 2,015,271</u>	<u>\$ (1,081,045)</u>	<u>\$ (983)</u>	<u>\$ 933,243</u>

Depreciation and amortization expense of \$1,094,957, \$1,166,245 and \$5,212,663 was recognized during the years ended December 31, 2011 and 2010 and during the period from inception, July 15, 2005, to December 31, 2011, respectively.

6. Accrued Liabilities

Accrued liabilities were comprised of the following at December 31,

	<u>2011</u>	<u>2010</u>
Deferred salaries	\$ 146,682	\$ 480,161
Other wages payable	107,178	19,132
Payroll taxes and benefits	67,812	67,873
Other	<u>2,525</u>	<u>52</u>
	<u>\$ 324,197</u>	<u>\$ 567,218</u>

7. Debt Obligations

Line of Credit, Related Party

During the year ended December 31, 2009, the Company entered into an uncollateralized line of credit with a vendor who is owned by a stockholder who is also a member of the board of directors in the amount of \$1,200,000. In May 2011, the Company entered into a note modification agreement which reduced the available line of credit to \$408,000 and extended the maturity date to May 31, 2012. During the year ended December 31, 2011, the vendor converted \$792,000 of the outstanding balance into 22 shares of Series C Preferred stock at \$36,000 per share based on market prices of preferred stock sold to investors through private placements. During the year ended December 31, 2010, this vendor converted \$510,000 of the outstanding balance into 17 shares of Series A Preferred Stock at \$30,000 per share based on market prices of preferred stock sold to investors through private placements. Following these conversions, the Company's outstanding balance at December 31, 2011 and 2010, on the line of credit was \$408,000 and \$690,000 plus accrued interest of \$56,795 and \$34,191, respectively. All principal and accrued unpaid interest shall be due and payable on or before May 31, 2012. The interest rate on this line of credit is equal to the current "prime" interest rate, 3.25% (as reported by Bloomberg, L.P.) at December 31, 2011.

AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Debt Obligations, continued

Notes Payable

The Company had the following short-term debt obligations at December 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Note payable to a governmental agency related to license fees for use of certain government owned technologies. The note was originated January 2010 and required 8 quarterly installments of \$2,528 maturing in October 2011. The note is uncollateralized and bears interest at 3%.	\$ -	\$ 7,359
Bonds payable to individual bond holders with principal and interest payable on demand or at month's end from date of issuance. The bonds bear interest at 6%. The Company issued the bonds in October and extended their repayment in each subsequent month through December 2011.	100,000	-
Note payable to a related party vendor who is owned by a stockholder and member of the Company's board of directors. The note is uncollateralized, bears no interest, and is due on demand.	20,000	-
Note payable to a related party, the Company's President and Chief Executive Officer, which is due on demand. The note is uncollateralized and bears no interest.	<u>155,051</u>	<u>-</u>
Total notes payable	<u>\$ 295,051</u>	<u>\$ 7,359</u>

For the years ended December 31, 2011 and 2010, the Company's weighted average interest rate and weighted average effective rate on outstanding short-term debt obligations is 2.85% and 3.99% and 3.25% and 3.25%, respectively.

8. Convertible Debentures

During the period from inception, July 15, 2005, to December 31, 2008, the Company issued \$6 million, of the Company's 4.75% Convertible Debentures ("Debentures"), to the Company's Chairman and Chief Executive Officer. The Debentures were due September 15, 2010, accrued interest at the rate of 4.75% per year and were not collateralized. Interest was payable in full upon maturity on September 15, 2010. All or any portion of the Debentures, including interest accrued thereon, were convertible into shares of the Company's common stock or preferred stock at the option of the holder at any time prior to the maturity date at conversion prices ranging from \$0.95 to \$4.76 per share.

On January 26, 2010, the holder of the convertible debentures elected to convert 100% of the \$6,000,000 outstanding principal and \$1,016,826 of accrued interest into 3,546,000 shares of common stock. The conversion prices for each of the debentures and corresponding interest are as follows:

<u>Debenture Amount</u>	<u>Accrued Interest Income</u>	<u>Conversion Price</u>
\$ 1,000,000	\$ 201,768	\$ 0.95
1,000,000	188,051	\$ 0.95
1,000,000	179,203	\$ 1.67
1,000,000	161,634	\$ 3.33
1,000,000	151,743	\$ 4.16
<u>1,000,000</u>	<u>134,427</u>	<u>\$ 4.76</u>
<u>\$ 6,000,000</u>	<u>\$ 1,016,826</u>	

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AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Stock Incentive Plan

A total of 1,500,000 shares of common stock are reserved for issuance under the Ad Astra Rocket Company 2005 Stock Incentive Plan (the "Plan"). The purpose of the Plan is to provide eligible persons who participate with an opportunity to acquire a proprietary interest in the Company as an incentive for them to remain in the service of the Company. Eligible persons include employees, non-employee members of the Board of Directors, consultants and other independent advisors who provide services to the Company.

The following table summarizes certain information relative to stock options:

	2005 Stock Incentive Plan	
	Shares	Weighted-Average Exercise Price
Outstanding inception through December 31, 2005	-	-
Granted	375,000	\$ 1.67
Forfeited/cancelled	-	-
Outstanding, December 31, 2006	375,000	1.67
Granted	66,000	4.22
Forfeited/cancelled	-	-
Outstanding, December 31, 2007	441,000	2.05
Granted	18,000	6.67
Forfeited/cancelled	(6,000)	4.17
Outstanding, December 31, 2008	453,000	2.20
Granted	123,000	6.67
Forfeited/cancelled	(54,000)	3.26
Outstanding, December 31, 2009	522,000	3.15
Granted	100,000	10.00
Forfeited/cancelled	(7,500)	6.67
Outstanding, December 31, 2010	614,500	4.22
Granted	-	-
Forfeited/cancelled	(19,500)	7.69
Outstanding, December 31, 2011	<u>591,625</u>	<u>\$ 4.06</u>
Exercisable, December 31, 2011	<u>490,000</u>	<u>\$ 3.07</u>

The weighted-average remaining life and the weighted-average exercise price of all of the options outstanding at December 31, 2011 was 5.76 years and \$4.06, respectively. The exercise prices for the options outstanding at December 31, 2011 ranged from \$1.67 to \$10.00, and information relating to these options is as 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>
\$0 - \$1.67	345,000	345,000	4.5 years	\$ 1.67	\$ 1.67
\$4.17	45,000	45,000	5.4 years	\$ 4.17	\$ 4.17
\$6.67	113,250	76,500	7.1 years	\$ 6.67	\$ 6.67
\$10.00	<u>88,375</u>	<u>23,500</u>	8.9 years	\$ 10.00	\$ 10.00
	<u>591,625</u>	<u>490,000</u>			

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AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Stock Incentive Plan, continued

The estimated fair value of the 100,000 stock options granted pursuant to the Plan during the year ended December 31, 2010 was \$8.90 per share using the Black-Scholes option pricing model. The fair values related to these issuances were calculated using the following assumptions in their respective years of issuance:

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Expected volatility	-	669.0%	681.0%	415.0%	425.0%	676.0%	-
Risk-free interest rate	-	1.15%	1.9%	2.4%	5.01%	5.0%	-
Expected life	-	10 years	10 years	10 years	10 years	10 years	-

During the years ended December 31, 2011 and 2010, the Company cancelled 19,500 and 7,500 options. The fair value of options expensed pursuant to the Plan during the years ended December 31, 2011 and 2010 and for the period from inception, July 15, 2005 through December 31, 2011 was \$249,713, \$163,144, and \$983,215, respectively.

As of December 31, 2011, there was approximately \$996,010 of total unrecognized option expense related to non-vested stock option grants.

10. Related Party Transactions

During the years ended December 31, 2011 and 2010, the Company incurred \$0 and \$12,737, respectively, in legal expenses to an individual who is also a director and stockholder of the Company. During the year ended December 31, 2011, the individual converted \$126,000 of accounts payable into 1,500 shares of Class B Common stock at \$12 per share and 3 shares of Class C Preferred shares at \$36,000. The common stock and preferred stock pricing was consistent with market value purchases of the Company's shares for cash at the time of the conversion. As of December 31, 2011 and 2010, the Company had a balance outstanding of \$0 and \$126,000, respectively, related to services rendered by this individual.

As of December 31, 2011 and 2010, the Company had an outstanding balance of \$199,893, related to systems integration services, to a vendor who is owned by a stockholder and member of the Company's board of directors. During 2010, the vendor temporarily sub-let rental space in the Company's Houston facility. This sub-let rental agreement ended in July 2010. The rental expense for the year ended December 31, 2010 was reduced by \$21,000 as a result of this agreement. There was no outstanding balance related to this sub-let rental agreement as of December 31, 2011 and 2010.

For the years ended December 31, 2011 and 2010, the Company leased its Costa Rica laboratory and warehouse from an investment fund that is controlled by an affiliate of the Company's investment banker and shareholder, with lease expenses totaling \$125,481 and \$122,789, respectively. As of December 31, 2011 and 2010, the Company had \$53,946 and \$0 in outstanding balances with this affiliate. For the years ended December 31, 2011 and 2010, the Company paid the investment banker commissions earned in connection with the sale of the Company's stock in the amount of \$199,388 and \$349,648..

In March 2010, the Company entered into a contract with the Costa Rican government and several small engineering firms in Costa Rica to design and manufacture a mock up of the platform to house the VASIMR engine on the International Space Station. This contract was funded by the Costa Rican government. The Company's proportionate share of the revenue is approximately \$48,000 of which \$15,412 and \$32,588 was recorded as other income for the years ended December 31, 2011 and 2010. As of December 31, 2011 and 2010, \$0 and \$2,600 remained in accounts receivable.

11. 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 purposes. For the years ended December 31, 2011 and 2010, there were no provisions for income taxes and net deferred tax assets have been entirely offset by a valuation allowance, due to the Company's unlikely realization. Significant components of the Company's deferred tax assets and liabilities, at December 31, 2011 and 2010 were as follows:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Income Taxes, continued

	<u>2011</u>	<u>2010</u>
Deferred tax assets:		
Net operating loss carry-forwards	\$ 7,542,703	\$ 6,712,511
Non-deductible accruals	356,294	200,046
Basis difference in property and equipment	<u>355,357</u>	<u>128,340</u>
Total deferred tax assets	<u>8,254,354</u>	<u>7,040,897</u>
Valuation allowance	<u>(8,254,354)</u>	<u>(7,040,897)</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, 2011 and 2010 is as follows:

	<u>2011</u>		<u>2010</u>
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>
Benefit for income tax at federal statutory rate	\$(1,454,324)	(34.0)	\$(1,640,053)
Increase in valuation allowance	1,213,457	28.4	1,389,664
Effect of foreign subsidiary losses	160,744	3.8	206,129
Conversion of vendor payable to common stock	42,840	1.0	-
Compensatory element of stock option grants	84,902	2.0	55,469
Other	<u>(47,619)</u>	<u>(1.2)</u>	<u>(7,309)</u>
	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>

As of December 31, 2011, for United States of America federal income tax reporting purposes, the Company has approximately \$22,184,000 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, 2031. 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 NOL 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.

12. Equity

Common Stock

The Company's Certificate of Incorporation authorizes the issuance of 75,000,000 shares of common stock, par value \$0.01 per share. The Board of Directors has the authority to issue any such shares that are not currently outstanding at such prices and other terms as are approved by the Board. The Company is not party to any agreements with any of its stockholders of any class that gives any such stockholders economic rights related to its shares of common stock that are not available to all holders of such class of common stock. In February 2010, the Company amended and restated its Certificate of Incorporation to reflect a change in preferred and common stock par value from \$.001 to \$0.01, and to eliminate its Class A and Class B Common Stock in favor of a single class of Common Stock.

During the year ended December 31, 2008, the Company declared a stock split by way of stock dividend of (1) 3,000 shares of Class A Common Stock for each outstanding share of Class A Common Stock, such that each holder of one share of Class A Common Stock exchanged such share for 3,000 shares of Class A Common Stock and (2) 3,000 shares of Class B Common Stock for each outstanding share of Class B Common Stock, such that each holder of one share of Class B Common Stock exchanged such share for 3,000 shares of Class B Common Stock. The conversion price for each outstanding share of Series A Preferred Stock was adjusted so that each share of Series A Preferred Stock shall be convertible into 3,000 shares of Class A Common Stock. Appropriate adjustments were made for each outstanding option in order to prevent the dilution or enlargement of rights and benefits. As a result, 13,086,000 Class B Common Stock shares and 2,781,000 Class A Common Stock shares were issued in exchange for 4,362 Class B Common Stock shares and 928 Class A Common stock shares, respectively, outstanding prior to the stock split dividend.

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AD ASTRA ROCKET COMPANY AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Equity, continued

At December 31, 2011 and 2010, the Company had 20,251,645 and 20,078,052 shares, respectively, of common stock issued and outstanding.

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. Common stockholders have no exchange or conversion rights and their shares are not subject to redemption.

On September 28, 2010, the Company received authorization by the Superintendencia General de Valores de Costa Rica ("SUGEVAL") to affect Restricted Public Offerings ("RPO") of its common stock. These offerings are conducted under Costa Rican securities law outside of the United States of America. The Company approved the issuance of up to 1,000,000 shares of Common Stock pursuant to the RPO, at an initial offering price of \$10.00 per share. The approval of the RPO by Sugeval resulted in the automatic conversion of 106 issued and outstanding shares of Series B Preferred Stock to 318,000 shares of common stock pursuant to the Series B designation agreement.

During the year ended December 31, 2011, the Company sold, pursuant to the RPO, 36,450 and 135,643 shares of common stock at a price of \$10.00 and \$12.00 per share resulting in cash proceeds of \$328,050 and \$1,429,989, net of issuances costs of \$36,450 and \$197,713. The Company also issued 1,500 shares of common stock at a price of \$12.00 per share, to a related party as a settlement for amounts due to the individual for services rendered to the Company. (See Footnote 10 for further discussion)

During the year ended December 31, 2010, the Company sold 44,504 shares of common stock in conjunction with a private placement for a price of \$9.17 per share resulting in cash proceeds of \$417,272 net of issuance costs of \$41,727. In addition, the Company sold 135,000 shares of common stock related to its RPO for a price of \$10 per share resulting in cash proceeds of \$1,350,000, net of issuance costs of \$277,669.

Preferred Stock

The Company has 10,000 authorized shares of preferred stock, par value \$0.01 per share. The preferred stock may be issued in series, from time to time, with such designations, rights, preferences, and limitations as the Board of Directors may determine by resolution.

Series A Preferred Stock

At December 31, 2011 and 2010, the Company had 2,200 shares authorized and 369 shares issued and outstanding of Series A preferred stock, par value \$0.01 per share ("Series A"). The Series A has a liquidation preference over common stockholders and is equal to the original purchase price and does not pay a mandatory dividend. The 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 or \$12 per share. The Company has the right to redeem the 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.

At December 31, 2011 and 2010, there were no accumulated, undeclared dividends.

Series B Preferred Stock

At December 31, 2011 and 2010, the Company had 1,000 shares authorized and none issued or outstanding of Series B Preferred Stock, par value \$0.01 per share ("Series B"), respectively. The Series B has a liquidation preference over common stockholders and is equal to the original purchase price and does not pay a mandatory dividend. The Series B 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 B original issue price by the Series B conversion price in effect at the time of conversion. The Series B conversion price is equal to the original

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Equity, continued

issue price per share divided by 3,000 or \$12 per share. The Company has the right to redeem the Series B for cash at any time after the three year anniversary date of the issuance at a redemption price calculated by multiplying the Series B 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 B 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 year ended December 31, 2010, the Company sold 70 shares of Series B Preferred Stock at \$27,510 per share for proceeds totaling \$1,749,113, net of issuance costs of \$176,586.

On September 28, 2010, as a result of the approval of the RPO in Costa Rica, the 106 shares of issued and outstanding Series B Preferred Stock were automatically converted into 318,000 shares of Common Stock. There were no accumulated or undeclared dividends at the time of conversion on December 31, 2009.

Series C Preferred Stock

At December 31, 2011 and 2010, the Company had 100 shares authorized and 25 and none issued and outstanding, respectively, of Series C Preferred, par value \$0.01 per share ("Series C"). The 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 or \$12 per common share. The Company has the right to redeem the Series C for cash at any time after issuance within twenty days of a written notice at a redemption price equal to the original issue price, plus all declared but unpaid dividends. The Series C stock may become mandatorily convertible to common shares at a conversion rate of 3,000 common stock for each Series C share held in the event of the Company closing the sale of its common stock to the public in an underwritten offering pursuant to an effective registration statement under the Securities Act of 1933, as amended.

During the year ended December 31, 2011, the Company issued 25 shares of Series C Preferred Stock to related parties, who converted \$792,000 of an outstanding line of credit and \$108,000 related to legal services provided by a director to the Company (See Footnote 8 and 10 for Further Discussion)

At December 31, 2011 and 2010, there were no accumulated or undeclared dividends.

13. Commitments

Operating Leases

In August 2007, the Company entered into a lease agreement for office and laboratory space in Webster, Texas. The term of the agreement was for sixty months with a base rent of \$13,162 per month plus a pro-rata share of operating expenses. There were no payments due during the first twelve months, hence, the Company has accounted for this as a lease incentive and recorded the deferred lease expense asset and corresponding payable on its balance sheet. In July 2008, the Company entered into a separate lease agreement for additional space for the existing lease entered in August 2007. The term of the agreement is for forty-seven months with a base rent of \$600 per month plus a pro-rata share of operating expenses.

Rent expense related to the Company's operating leases for the years ended December 31, 2011 and 2010 and the period from inception July 15, 2005, to December 31, 2011 totaled \$317,982, \$288,308, and \$1,116,656, respectively, on a straight-line basis. The Company recorded a rent benefit associated with the deferred lease of \$31,584, \$31,584, and \$139,498, respectively, for the years ended December 31, 2011, 2010 and for the period from inception, July 15, 2005, to December 31, 2011. The remaining deferred lease expense balance at December 31, 2011 and 2010 was \$18,442 and \$50,026, respectively.

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13. Commitments, continued

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>
2012	\$ <u>96,334</u>

Capital Leases

Assets under capital leases are capitalized using the contractual interest rate of 4.75%, for a period of 60 months ending in 2014. Following is an analysis of assets under capital leases at December 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Machine shop equipment	\$ 159,719	\$ 159,719
Less accumulated depreciation	<u>(118,559)</u>	<u>(86,619)</u>
	<u>\$ 41,160</u>	<u>\$ 73,100</u>

Future minimum lease payments for the above assets under capital leases at December 31 2011 are as follows:

2012	\$ 31,083
2013	8,016
2014	<u>2,988</u>
Total minimum obligations	<u>42,087</u>
Interest	<u>(1,603)</u>
Present value of net minimum obligations	40,484
Current portion of obligation	<u>(29,852)</u>
Long-term portion of obligation	<u>\$ 10,632</u>

The Company recorded amortization expense related to its capital leases of \$31,940 and \$31,941, and \$138,359 for the years ended December 31, 2011 and 2010, and for the period from inception, July 15, 2005 to December 31, 2011, respectively.

14. Supplemental Cash Flow Information and Non-Cash Transactions

	<u>Year Ended</u> <u>December 31, 2011</u>	<u>Year Ended</u> <u>December 31, 2010</u>	<u>Period from</u> <u>Inception</u> <u>July 15, 2005 to</u> <u>December 31, 2011</u>
Supplemental disclosures of cash flow information:			
Cash paid for:			
Interest	\$ <u>-</u>	\$ <u>-</u>	\$ <u>100,320</u>
Income taxes	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>

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14. Supplemental Cash Flow Information and Non-Cash Transactions, continued

Non-cash operating, investing and financing activities:

Equipment acquired through capital lease obligation	\$ <u>-</u>	\$ <u>-</u>	\$ <u>159,719</u>
Stock dividend	\$ <u>-</u>	\$ <u>-</u>	\$ <u>15,864</u>
Royalty payable converted into a note payable	\$ <u>-</u>	\$ <u>-</u>	\$ <u>20,000</u>
Conversion of vendor payable, related party to common stock	\$ <u>18,000</u>	\$ <u>-</u>	\$ <u>18,000</u>
Conversion of vendor payable, related party to preferred stock	\$ <u>108,000</u>	\$ <u>-</u>	\$ <u>108,000</u>
Conversion of convertible debentures and, accrued interest, related party to common stock	\$ <u>-</u>	\$ <u>7,016,826</u>	\$ <u>7,016,826</u>
Conversion of line of credit, related party to preferred stock Series A	\$ <u>-</u>	\$ <u>510,000</u>	\$ <u>1,302,000</u>
Conversion of line of credit, related party to preferred stock Series C	\$ <u>792,000</u>	\$ <u>-</u>	\$ <u>-</u>

15. Going Concern

As a research and development enterprise, the Company has not generated significant revenue related to its intended operations since its inception and thereby has experienced recurring net losses and negative cash flows from operations as follows. During the years ended December 31, 2011 and 2010 and during the period from Inception, July 15, 2005, to December 31, 2011, the Company's net losses were \$4,277,425, \$4,823,688, and \$28,851,951, and net cash used in operating activities was \$2,859,814, \$3,354,222, and \$20,229,964. During the years ended December 31, 2011 and 2010 the Company had a working capital deficit of \$1,821,242 and \$1,531,997. 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 and preferred stock, the issuance of convertible debentures and borrowings on its line of credit from related parties.

The Company received net cash from its financing activities for the periods ended December 31, 2011 and 2010 and during the period from Inception, July 15, 2005, to December 31, 2011 of \$2,505,263, \$3,755,294, and \$26,472,814, respectively.

Management plans to continue to focus on 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 sources of equity or debt funding to meet current commitments and fund the continuation of its business operations and the ability of the Company to ultimately achieve adequate profitability and cash flows from operations to sustain its operations.

16. 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 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, 2011, there were no pending claims or legal actions in which the Company was involved.

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17. Subsequent Events

Subsequent to December 31, 2011, the Company entered into the following financing transactions:

INS Fondo de Inversion No Diversificado Aurora CR1 (the "Aurora Fund") is a SUGEVAL authorized non-diversified closed end investment fund created in January 2012 and authorized to raise up to \$10 billion Costa Rican Colones (or approximately \$19 million USD) whose investment term expires on January 25, 2018. The Aurora Fund may invest up to 40% of its fund assets in the common stock of the Company. During February 2012, the Aurora Fund purchased 34,043 shares of the Company's common stock at \$12 per share for a total investment of \$367,657 net of issuance costs of \$40,851.

The Company sold 23,456 shares of its common stock at \$12 per share thru the RPO for a total investment of \$253,294, net of issuance costs of \$28,147.

During 2012 a private investor purchased, through a private placement, 1 share of Series A preferred stock, convertible into 3,000 shares of Common stock with net proceeds to the Company of \$36,000. There were no issuance fees related to the private placement.

The Company paid its outstanding bonds payable principal and accrued interest in the amount of \$103,038 during February 2012.

Subsequent events have been evaluated through March 15, 2012 which is the date the financials statements were available for issuance.