EL-HILALI OUSSAMA
Form 4
December 20, 2011

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
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(Print or Type Responses)

1. Name and Address of Reporting Person *
EL-HILALI OUSSAMA

(Last) (First) (Middle)

C/O CARBONITE, INC., 177 HUNTINGTON AVENUE

(Street)

BOSTON, MA 02115

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Carbonite Inc [CARB]

3. Date of Earliest Transaction (Month/Day/Year)
12/15/2011

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
SVP Engineering

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security	2. Conversion or Exercise	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any	4. Transaction Code	5. Number of Derivative Securities	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount of Underlying Securities (Instr. 3 and 4)	8. D S

(Instr. 3)	Price of Derivative Security	(Month/Day/Year)	(Instr. 8)		Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)					(I
			Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares
Stock Option (right to buy)	$ 12.88	12/15/2011	A		20,000		(1)	12/15/2021	Common Stock	20,000

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
EL-HILALI OUSSAMA C/O CARBONITE, INC. 177 HUNTINGTON AVENUE BOSTON, MA 02115			SVP Engineering	

Signatures

/s/ Danielle Sheer, by power of attorney	12/20/2011
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) This option becomes exerciseable as to 60% of the underlying shares of common stock in 8 equal quarterly installments beginning on March 15, 2012 and as to 40% of the underlying shares of common stock in 4 equal quarterly installments beginning on March 15, 2014.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. - 257,213 Less cost of capital - - - (10,000) Loan fees and costs - - 37,500 38 65,212 Employee bonus - - 8,334 8 17,325 Payment of preferred stock dividends - - 23,615 24 44,400 Dividends declared on Preferred Stock - - - - - Change in derivative related to note conversion - - - - - Net loss for the year - - - - - ----------- ----------- ------------ ---------- ----------------- Balances at December 31, 2005-Restated 1,990,162 1,990 4,172,983 4,173 25,394,233 Conversion of preferred stock into common stock (36,680) (37) 831,412 831 (794) Issuance of preferred stock for cash 100,000 100 - - 499,900 Cash redemption of preferred stock (50,000) (50) - - (249,950) Issuance of common stock for Cash for retirement of convertible debenture, working capital advances and settlement of stock subscription receivable - - 16,859,338 16,859 3,161,702 Employee bonus - - 41,666 42 17,458 Payment of preferred stock dividends - - 50,135 50 19,127 Payment of accrued interest payable and reimbursement of expenses paid by shareholder - - 1,051,973 1,052 83,106 Cost of capital for preferred and common stock sales - - - - (415,000) Consulting expense for value of common stock issued at less than "fair value" - - - - 5,191,531 Dividends declared on preferred stock - - - - - Change in derivative related to note conversion - - - - - Net loss for the year - - - - - --------------- ----------- --------- Balances at December 31, 2006-Restated 2,004,562 $ 2,004 23,007,902 $ 23,008 $ 33,701,314 ============ =========== ============ ========== ================= - Continued -

F-6 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY Years ended December 31, 2006 and 2005 (Continued) Accumulated other comprehensive Accumulated income deficit Total ------------ ---------------- ------------- $ - $ (19,989,875) $ 4,559,698 - - - - - 436,607 - - 257,213 - - (10,000) - - 65,250 - - 17,333 - - 44,424 - (56,253) (56,253) 42,550 - 42,550 - (6,067,084) (6,067,084) ------------ ---------------- ------------- 42,550 (26,113,212) (845,264) - - - - - 500,000 - - (250,000) - - 3,178,561 - - 17,500 - - 19,177 - - 84,158 - - (415,000) - - 5,191,531 - (62,165) (62,165) (3,970,721) - (3,970,721) - (8,561,975) (8,561,975) $ (3,928,171) $ (34,757,352) $ (4,939,197) ============ ================ ============= Stock subscription receivable at December 31, 2006 and 2005, respectively was $-0- and $175,000. The accompanying notes are an integral part of these consolidated financial statements. F-7 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS Years ended December 31, 2006 and 2005 (Restated) (Restated) Year ended Year ended December 31, December 31, 2006 2005 ------------- ------------- Cash flows from operating activities Net loss for the year $ (8,561,975) $ (6,067,084) Adjustments to reconcile net loss to net cash provided by operating activities Depreciation and amortization 602,021 967,612 Bad debt expense 12,089 12,463 Payment of expenses with common stock 412,732 17,333 Consulting expense related to common stock issuances at less than "fair value" 5,191,533 257,213 (Increase) Decrease in Accounts receivable 162,700 55,554 Inventory 49,986 352,334 Prepaid expenses, deposits and other (2,270) 2,057 Increase (Decrease) in Accounts payable and other accrued liabilities 207,448 (90,269) Accrued payroll payable 168,235 109,959 Accrued interest payable 84,441 11,388 Customer deposits (42,850) (208,216) ------------- ------------- Net cash provided by (used in) operating activities (1,715,910) (1,801,824) ------------- ------------- Cash flows from investing activities Purchase of property and equipment (31,024) (124,198) ------------- ------------- Net cash used in investing activities (31,024) (124,198) ------------- ------------- Cash flows from financing activities Proceeds from loans from stockholders 100,000 975,000 Cash paid to retire convertible debenture (585,000) - Cash received on working capital advances 2,200,000 150,000 Cash received on sale of preferred stock 500,000 - Cash paid to retire preferred stock (275,000) - Cash received on issuance of mandatory convertible debenture - 436,607 Cash received on sale of common stock 1,000,000 - Cash paid to acquire capital (415,000) (10,000) ------------- ------------- Net cash provided by financing activities 2,525,000 1,551,607 ------------- ------------- INCREASE (DECREASE) IN CASH 788,066 (374,415) Cash at beginning of year 431,050 805,465 ------------- ------------- Cash at end of year $ 1,209,116 $ 431,050 ============= ============= Supplemental disclosure of interest and income taxes paid Interest paid for the period $ 34,227 $ 19,770 ============= ============= Income taxes paid for the period $ - $ - ============= ============= Supplemental disclosure of non-cash investing and financing activities Conversion of working capital advances into common stock $ 2,200,000 $ 40,000 ============= ============= Payment of accrued dividends on preferred stock with common stock $ 19,177 $ 44,424 ============= ============= The accompanying notes are an integral part of these consolidated financial statements. F-8 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2006 and 2005 Note A - Organization and Description of Business American Ammunition, Inc. (AAI or Company) was incorporated on February 1, 2000 in accordance with the Laws of the State of California. The Company functions as a holding company providing management oversight services to it's wholly-owned operating subsidiaries; F&F Equipment, Inc. and Industrial Plating Enterprise Co. F&F Equipment, Inc.(F&F) was incorporated on October 4, 1983 in accordance with the Laws of the State of Florida. F&F is engaged in the design, manufacture and international sales of small arms ammunition. F&F has conducted its business operations under the assumed name of "American Ammunition" since its inception. Industrial Plating Enterprise Co. (IPE), which was incorporated and commenced production on June 14, 2002. IPE is a fully licensed and approved state of the art electrochemical metallization facility for processing the Company's line of small arms projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques. The facility meets or exceeds all current environmental requirements and enjoys the "conditionally exempt small quantity generator" status for State and Federal regulations. All activities of IPE since it's inception have been dedicated to the needs and demands of F&F. On January 9, 2006, by written consent in lieu of meeting, a majority of the Company's stockholders approved a recommendation by the Company's Board of Directors to effect a one share for twenty shares reverse stock split of our common stock, par value $.001 per share, with fractional shares rounded up to the nearest whole share. The reverse split became effective on that date. As a result of the reverse split, the total number of issued and outstanding shares of the Company's common stock decreased from

92,576,839 to 4,629,381shares, after giving effect to rounding for fractional shares. The effect of this action is reflected in the Company's financial statements as of the first day of the first period presented. Note B - Preparation of Financial Statements The Company and its subsidiaries follow the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and have adopted a year-end of December 31 for all entities. 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 assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management further acknowledges that it is solely responsible for adopting sound accounting practices, establishing and maintaining a system of internal accounting control and preventing and detecting fraud. The Company's system of F-9 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note B - Preparation of Financial Statements - Continued internal accounting control is designed to assure, among other items, that 1) recorded transactions are valid; 2) valid transactions are recorded; and 3) transactions are recorded in the proper period in a timely manner to produce financial statements which present fairly the financial condition, results of operations and cash flows of the Company for the respective periods being presented For segment reporting purposes, the Company operated in only one industry segment during the periods represented in the accompanying financial statements and makes all operating decisions and allocates resources based on the best benefit to the Company as a whole. The accompanying consolidated financial statements contain the accounts of American Ammunition, Inc. and its wholly-owned subsidiaries, F&F Equipment, Inc. and Industrial Plating Enterprise Co. All significant intercompany transactions have been eliminated. The consolidated entities are collectively referred to as "Company". Note C - Going Concern Uncertainty The Company continues to experience fluctuating periodic revenues, as demonstrated in Note P. The Company's operations consistently demonstrate a negative cash flow position as evidenced by net cash used in operating activities of approximately \$(1,716,000), \$(1,802,000), \$(649,000), \$(2,918,000), \$(1,236,000) and \$(1,100,000) for each of the respective years ended December 31, 2006, 2005, 2004, 2003, 2002 and 2001. The Company has sustained liquidity through the sale of equity securities, restricted and unrestricted, domestically and in international markets and significant working capital advances have been made by members of management and/or existing shareholders. Future liquidity may be dependent upon future offerings of debt and/or equity securities; however, the availability of further liquidity from these sources is uncertain. The Company's continued existence is principally dependent upon its ability to generate sufficient cash flows from operations to support its daily operations on a timely basis. There is no assurance that the Company will be able to obtain raw materials in sufficient quantity, due to its financial condition, to ensure success of its business plan. Further the ability to obtain additional funding through the sales of additional equity securities or, that such funding, if available, will be obtained on terms favorable to or affordable by the Company is uncertain. The Company anticipates that additional working capital will be necessary to support and preserve the integrity of the corporate entity. However, there is no assurance that the Company will be able to obtain additional funding through either bank lines-of-credit or the sale of additional equity securities or, that such funding, if available, will be obtained on terms favorable to or affordable by the Company. If no additional operating capital is received during the next twelve months, the Company will be forced to rely on existing cash in the bank, the cash generated from operating activities and/or additional funds loaned by the Company's management and/or shareholders to preserve the integrity of the corporate entity. In the event, the Company is unable to acquire advances from management and/or significant stockholders, the Company's ongoing operations would be negatively impacted to the point that all operating activities are ceased. While the Company is of the opinion that good faith estimates of the Company's ability to secure additional capital in the future to reach our goals have been made, there is no guarantee that the Company will receive sufficient funding to sustain operations or implement any future business plan steps. F-10 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note D - Summary of Significant Accounting Policies 1. Cash and cash equivalents For Statement of Cash Flows purposes, the Company considers all cash on hand and in banks, certificates of deposit and other highly-liquid investments with maturities of three months or less, when purchased, to be cash and cash equivalents. Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies. 2. Accounts receivable and Revenue

Recognition In the normal course of business, the Company extends unsecured credit to virtually all of its customers which are located throughout the United States. Because of the credit risk involved, management has provided an allowance for doubtful accounts which reflects its opinion of amounts which will eventually become uncollectible. In the event of complete non-performance, the maximum exposure to the Company is the recorded amount of trade accounts receivable shown on the balance sheet at the date of non-performance. The Company ships all product on an FOB-Plant, "as-is" basis. Accordingly, revenue is recognized by the Company at the point at which an order is shipped at a fixed price, collection is reasonably assured and the Company has no remaining performance obligations related to the sale. The Company sells all products with "no right of return" by the purchaser for any factor other than defects in the product's production. On rare occasion, the Company may elect to accept product returns from customers on a case-by-case basis to offset unpaid accounts receivable. These situations are a "last case" scenario and are initiated by senior management through negotiations with the respective customer. 3. Inventory Inventory consists of raw materials, work-in-process and finished goods related to the production and sale of small arms ammunition. Inventory is valued at the lower of cost or market using the first-in, first-out method. In November 2004, Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("Statement") No. 151, "Inventory Costs - an amendment of Accounting Research Bulletin No. 43, Chapter 4." Statement No. 151 requires that abnormal amounts of costs, including idle facility expense, freight, handling costs and spoilage, should be recognized as current period charges. The provisions of this Statement became effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Statement No. 151 was adopted the Company on January 1, 2006. There was no material impact resulting from the adoption of Statement No. 151 on the Company's financial statements. 4. Property, plant and equipment Property and equipment are recorded at historical cost. These costs are depreciated over the estimated useful lives of the individual assets using the straight-line method, generally three to ten years. Gains and losses from disposition of property and equipment are recognized as incurred and are included in operations. In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company follows the policy of evaluating all property and equipment as of the end of each reporting quarter. At December 31, 2005, pursuant to the requirements of this accounting standard, management recorded an impairment for the future recoverability of these assets of approximately $2,777,829. F-11 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note D - Summary of Significant Accounting Policies - Continued 5. Income Taxes The Company uses the asset and liability method of accounting for income taxes. At December 31, 2005 and 2004, the deferred tax asset and deferred tax liability accounts, as recorded when material to the financial statements, are entirely the result of temporary differences. Temporary differences represent differences in the recognition of assets and liabilities for tax and financial reporting purposes, primarily accumulated depreciation and amortization, allowance for doubtful accounts and vacation accruals. As of December 31, 2006 and 2005, the deferred tax asset related to the Company's net operating loss carryforward is fully reserved. In the event that these carryforwards were not fully utilized, they began to expire in 2005. 6. Earnings (loss) per share Basic earnings (loss) per share is computed by dividing the net income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the respective period presented in our accompanying financial statements. Fully diluted earnings (loss) per share is computed similar to basic income (loss) per share except that the denominator is increased to include the number of common stock equivalents (primarily outstanding options and warrants). Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method, at either the beginning of the respective period presented or the date of issuance, whichever is later, and only if the common stock equivalents are considered dilutive based upon the Company's net income (loss) position at the calculation date. As of December 31, 2006 and 2005, and subsequent thereto, the Company had no options outstanding. The outstanding warrants, mandatory convertible preferred stock and mandatory convertible debentures are anti-dilutive due to the Company's net operating loss position. 7. Advertising costs The Company does not conduct any direct response advertising activities. For non-direct response advertising, the Company charges the costs of these efforts to operations at the first time the related advertising is published. 8. Pending and/or New Accounting Pronouncements The Company is of the opinion that any pending accounting pronouncements, either in the adoption phase or not yet required to be adopted, will not have a significant impact on the Company's financial position or results of operations. F-12 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note E - Correction of an Error On August 22, 2007, our management concluded that the financial statements included in our Forms 10-QSB for June and September 2005, the calendar year 2006 and for the period ending March 31, 2007, and the Forms 10-KSB for the periods ending December 31, 2005 and December 31, 2006, all of which have been previously filed with the Securities and Exchange Commission, need to be restated, due to the failure to include the beneficial conversion feature discount on unsecured convertible indebtedness. Management discovered such changes needed to be made after consulting with Pollard-Kelley Auditing Services, our independent registered public accounting firm as of June 26, 2007, who have concurred with management as to the reexamination of the above mentioned issues. The Company has entered into certain notes payable to shareholders and other affiliated parties with embedded conversion features and warrant issues. The appropriate accounting is governed by EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The fair value is determined to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis. Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt. [Balance of this page intentionally left blank.] F-13 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note E - Correction of an Error - Continued The errors discovered by management relate directly to the accounting for and recording various conversion features and warrants as follows: Year ended Year ended December 31, December 31, 2006 2005 ------------- -------------- Net Loss, as previously reported $(8,100,057) $(5,941,669) Effect of the correction of an error (Increase) Decrease in Net Loss by financial statement line item: Operating expenses: Interest expense recognized from beneficial conversion discount feature on notes payable to shareholders and other affiliates (461,918) (125,415) ------------- -------------- Total effect of changes on Loss from Operations and Net Loss (461,918) (125,415) ------------- -------------- Net Loss, as restated $ (8,561,975) $ (6,067,084) ============== =============== Net loss available to common stockholders, as previously reported $ (8,162,222) $ (5,997,922) Effect of the correction of an error Total effect as shown above (461,918) (125,415) ------------- -------------- Net Loss available to common stockholders, as restated $ (8,624,140) $ (6,080,787) ============== =============== Earnings per share, as previously reported $ (0.96) $ (1.53) Total effect of changes (0.05) (0.03) ------------- -------------- Earnings per share, as restated $ (1.01) $ (1.56) ============== =============== In light of the restatements to the financial statements disclosed above, caused, in part, by a failure in the Company's internal control over financing reporting due to the limitations in the Company's accounting resources to identify and react in a timely manner to non-routine, complex and/or transactions originated by other parties on the Company's behalf, as well as gaining an adequate understanding of the disclosure requirements relating to these types of transactions, we feel that the existing controls and procedures were and remain effective. Because of said controls, which resulted in the review, discovery and disclosure by amendment of filings to adequately disclose required information, management also concludes that by requiring supplemental reviews of financing transactions that its existing controls and procedures will be more effective. Note F - Fair Value of Financial Instruments The carrying amount of cash, accounts receivable, accounts payable and notes payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions. Interest rate risk is the risk that the Company's earnings are subject to fluctuations in interest rates on either investments or on debt and is fully dependent upon the volatility of these rates. The Company does not use derivative instruments to moderate its exposure to interest rate risk, if any. Financial risk is the risk that the Company's earnings are subject to fluctuations in interest rates or foreign exchange rates and are fully dependent upon the volatility of these rates. The company does not use derivative instruments to moderate its exposure to financial risk, if any. F-14 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note G - Concentrations of Credit Risk The Company maintains its cash accounts in a single financial institutions subject to insurance coverage issued by the Federal Deposit Insurance Corporation (FDIC). Under FDIC rules, the Company and its subsidiaries are entitled to aggregate coverage of $100,000 per account type per separate legal entity per financial institution. During the period ended December 31, 2006 and 2005 and the periods subsequent thereto, respectively, the various operating companies maintained deposits in this financial institution with credit risk exposures in excess of statutory FDIC coverage. The Company incurred no losses through December 31, 2006, and subsequent thereto, as a result of any of these unsecured situations. Note H - Inventory As of December 31, 2006 and 2005, inventory consisted of the following components: December 31, December 31, 2006 2005 ------------- ------------ Raw materials $375,732 $522,524 Work in process 119,851 30,103 Finished goods 14,521 7,463 -------- -------- Totals $510,104 $560,090 ======== ======== Note I - Property and Equipment Property and equipment consist of the following components: December 31, December 31, Estimated 2006 2005 useful life ------------ ------------- ------------ Manufacturing equipment $ 7,944,673 $ 8,095,110 3-10 years Office furniture and fixtures 69,889 69,889 3- 7 years Leasehold improvements 184,939 190,277 8-20 years ------------ ------------ 8,199,501 8,355,276 Accumulated depreciation (5,575,782) (5,577,447) Impairment of recoverability of carrying value (2,623,719) (2,777,829) ------------ ------------ Net property and equipment $ - $ - ============ ============ Total depreciation expense charged to operations for the years ended December 31, 2006 and 2005 was approximately $31,024 and$775,753, respectively. In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company follows the policy of evaluating all property and equipment as of the end of each reporting quarter. At December 31, 2005, pursuant to the requirements of this accounting standard, management recorded an impairment for the future recoverability of these assets of approximately $2,777,829. F-15 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note J - Loans from Shareholders December 31, December 31, 2006 2005 ------------ ------------ Four separate notes payable to three separate stockholders. Interest at 8.0%, payable monthly. Principal due at maturity on December 31, 2008. Shareholder/lender has the option to convert the principal amount into common stock of the Company at the lesser of 66-2/3% of the average closing bid and ask price on the date of conversion or $0.08 per share, whichever is less. Each note is unsecured. $ 1,075,000 $ 650,000 ============ ============ Note K - Federal Excise Taxes Payable On March 29, 2007, the Company reached a settlement and executed a Payment Agreement with the Department of the Treasury, Bureau of Alcohol, Tobacco and Firearms, related to a audit of the Company's Federal Excise Taxes obligation. The audit commenced during 2006. The Payment Agreement calls for the Company to pay an aggregate total of $300,000, plus interest at the statutory rate starting on March 29, 2007. The payment schedule is as follows: April 2007 through March 2008 - $3,000 per month; April 2008 - March 2009 - $4,000 per month; and April 2009 - March 2013 - $5,000 per month. This obligation has been fully accrued in the accompanying financial statements as of December 31, 2006. Note L - Convertible Debenture As of September 30, 2006, the outstanding balance on the La Jolla convertible debenture has been retired. A recap of the debenture activity is as follows: Debenture Warrant (in dollars) (in shares) ------------------------ Initial amount $ 600,000 6,000,000 2003 redemptions (208,635) (2,086,350) 2004 redemptions (125,000) (1,250,000) 2005 redemptions (40,000) (400,000) 2006 retirement (226,365) (2,263,650) ---------- ---------- Balances outstanding at September 30, 2006 $ - - ========== ========== In addition to retiring the debenture, the Company repaid $200,000 in prepaid warrant exercises and approximately $158,635 in negotiated prepayment and penalty fees for an aggregate payment of $585,000. Additionally, the Company recognized a charge to operations, including the aforementioned $158,635 cash payment, of approximately $354,450 for the issuance of 56,003 shares of common stock to La Jolla and the forgiveness of $175,000 in monies due from La Jolla for common stock issued on warrant exercises in prior periods. F-16 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note L - Convertible Debenture - Continued On September 13, 2006, La Terraza Trading and Asset Management Ltd. ("Investor") deposited a total of $2,150,000 in escrow for the use and benefit of the Company. The escrow deposit was for the following: 1. The sum of $585,000 was paid to La Jolla Cove Investors, Inc. ("La Jolla") to acquire for Investor a full and complete assignment of any and all of La Jolla's right, title and interest in any and all of AAMU indebtedness to La Jolla and specifically including La Jolla's rights under the active SB-2 Registration Statement for the issuance and registration of securities thereunder; the consent of AAMU to the foregoing subject to the right of AAMU to prepay any and all indebtedness thereunder in AAMU common stock, without penalty, at any time before or after default. 2. The sum of $275,000 to be used by AAMU to redeem and satisfy in full the Series E Preferred Stock funded by third party investors on or about July 12, 2006, including a prepayment redemption penalty of $25,000. 3. The sum of $215,000 payable as fees to Capital Investment Services, Inc. ("CIS") for locating, negotiating and closing the funding. 4. The sum of $100,000 to repay in full, without interest, an unsecured bridge loan from Investor to AAMU dated and funded on August 25, 2006. 5. The sum of $275,000 released to AAMU for working capital. 6. The balance of $700,000, to be retained in escrow and disbursed to AAMU for payment in reduction of the assigned La Jolla debenture and required warrant exercised thereunder, until the debenture and warrant obligations are satisfied in full in accordance with the terms of the assigned La Jolla documents. The financing transaction requires AAMU to deposit in escrow with CIS for later delivery a total of 11,470,000 shares of its common stock (to be held as unissued and not outstanding) to guarantee availability of stock as required for the reduction of the debenture and satisfaction of warrant obligations. Escrow agreement calls for Escrow Agent to release such shares for delivery in accordance with the terms of the pending SB-2 Registration Statement of AAMU currently on file with the SEC and in accordance with the terms and conditions of the Financing Agreement dated September 2006 entered into between AAMU and the Investor, and only after reasonable notification thereof to AAMU prior to delivery of any such certificates. Disbursement and distribution of shares shall only be made in accordance with the terms of the applicable SB-2 registration. The Investor and/or the selling stockholder has contractually agreed to restrict its ability to convert or exercise its warrants and receive shares of AAMU common stock such that the number of shares held by them and their affiliates after such conversion or exercise does not exceed 4.9% of the then issued and outstanding shares of common stock. The agreement also calls for an additional 5,000,000 shares of the restricted common stock of AAMU to be deposited in a separate escrow to be used for any other expenses and compensation to third parties that may be agreed upon between Investor and AAMU for future services to advance the overall business of AAMU. In addition AAMU granted Investor 600,000 warrants exercisable at the lesser of $0.1875 per share or the average closing price per share for the common stock during the twelve (12) month period prior to the date of exercise, such warrants exercisable at any time on or before five (5) years from and after July 24, 2006. All shares required to be deposited into escrowed have in fact been deposited in escrow on September 26, 2006 as required. The Investor provided additional funding in the amount of $1,000,000 to AAMU on December 21, 2006 for an additional 5,333,335 shares. The sum of $100,000 was paid as fees to CIS for locating, negotiating and closing the additional funding. All other terms and conditions of the escrow agreement and related financing agreement, including in corporation of the terms of the SB-2 requirements, remain the same. F-17 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note L - Convertible Debenture - Continued Discussion of retired debenture The debentures bore interest at 8% and were scheduled to mature on June 31 [sic], 2007, and were convertible into the Company's common stock, at the selling stockholder's option. The convertible debentures were convertible into the number of the Company's shares of common stock equal to the principal amount of the debentures being converted multiplied by 11, less the product of the conversion price multiplied by 10 times the dollar amount of the debenture. The conversion price for the convertible debentures is the lesser of (I) $1.00 or (ii) seventy six percent of the average of the five lowest volume weighted average prices during the twenty (20) trading days prior to the conversion. Accordingly, there is in fact no limit on the number of shares into which the debenture may be converted. However, in the event that our market price is less than $0.30 per share, the Company will have the option to prepay the debenture at 125% rather than have the debenture converted. In addition, the selling stockholder is obligated to exercise the warrant concurrently with the submission of a conversion notice by the selling stockholder. As of December 31, 2006, the warrant has been cancelled due to the repayment and final settlement on the convertible debenture. In December 2004, we entered into an addendum to the convertible debenture and warrant whereby the Company agreed to the following: * the discount multiplier was reduced from eighty percent to seventy six percent; * within five business days after this registration statement being declared effective, La Jolla is required to submit a debenture conversion in the amount of $10,000 and every ten business days thereafter La Jolla shall submit three additional debenture conversion in the amount of $10,000 each; * within five business days after this registration statement being declared effective, La Jolla shall wire $400,000 to us as a prepayment towards the exercise of its warrant; and * immediately following the sale of all shares held by La Jolla in connection with the debenture conversions in the aggregate amount of $40,000, La Jolla shall wire $275,000 to us as a prepayment towards the exercise of its warrant and shall submit a debenture conversion in the amount of $6,250 on the first business day of each month until the debenture is no longer outstanding. In May 2005, we entered into an additional addendum to the convertible debenture and warrant whereby the Company agreed to the following: * The Company shall deposit 4,000,000 unregistered shares in the name of LaJolla with the Company's Escrow Agent and, upon confirmation of receipt, LaJolla will wire the Company $150,000 as an advance on the $400,000 amount that LaJolla was obligated to fund pursuant to the December 2004 Addendum. In the event that the Company's Registration Statement was not declared effective within nine (9) months of the date of this Addendum, the 4,000,000 shares in escrow will be released to LaJolla and sold by LaJolla pursuant to Rule 144. If LaJolla sells these shares for net sales proceeds of more than $150,000 (without interest accruing on this amount), the excess over $150,000 will be refunded to the Company. F-18 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note L - Convertible Debenture - Continued Discussion of retired debenture - continued * The maturity date of the convertible debenture and warrant was extended to June 31, [sic], 2007. * All other terms and conditions remain in full force and effect. LaJolla has contractually agreed to restrict its ability to convert or exercise its warrants and receive shares of our common stock such that the number of shares of common stock held by them and their affiliates after such conversion or exercise does exceed 4.9% of the then issued and outstanding shares of common stock. Due to the contractually agreed mandatory conversion of this Debenture, the Company has reflected this transaction in its balance sheet as a "mezzanine" level debt obligation on its balance sheet, between "Total Liabilities" and "Stockholders' Equity". Upon the respective mandatory conversion, the Company will relieve the respective portion of the Debenture and the any related accrued, but unpaid interest, and credit this amount to the respective "common stock" and "additional paid-in capital" accounts in the stockholder's equity section for the par value and excess amount over the par value of the respective shares issued. As the warrant is non-detachable from the Debenture and requires simultaneous exercise upon conversion of the Debenture, no value was assigned to the issued warrant. Upon exercise of the warrant, the Company will record the issuance of the underlying shares as a new issuance of common stock on the date of each respective exercise. On various dates through December 31, 2003, the Debenture Holder elected to convert an aggregate $208,635, through 24 separate transactions, in outstanding Debenture principal into restricted, unregistered common stock. This election caused the Company to issue 4,561,753 shares of restricted, unregistered common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 2,086,350 shares of the Company's restricted, unregistered common stock for gross proceeds of $2,086,350. On various dates between January 1, 2004 and December 31, 2004, the Debenture Holder elected to convert an aggregate $125,000, through 6 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 4,150,000 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 1,250,000 shares of the Company's common stock for gross proceeds of $1,250,000. As of December 31, 2004, an aggregate of 1,000,000 shares of the Company's common stock have been issued by the Company and are being held in escrow by the Company's counsel pending receipt of the final $175,000 from the Debenture Holder. As of December 31, 2005, this amount remains unpaid. On various dates between June 28, 2005 and August 10, 2005, the Debenture Holder elected to convert an aggregate $40,000, through 4 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 5,872,048 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 400,000 shares of the Company's common stock for gross proceeds of $400,000. As of December 31, 2006, the Company has no continuing obligation under the convertible debenture and attached warrant. F-19 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note M - Derivative Liability arising from Warrants The Company accounts for debt with embedded conversion features and warrant issues in accordance with EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The Company determines the fair value to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis. Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt. Note N - Preferred Stock Transactions Preferred stock consists of the following as of December 31, 2006 and 2005, respectively: December 31,2006 December 31, 2005 ---------------- ----------------- # shares value # shares value --------- --------- ---------- --------- Series A Cumulative Convertible Preferred Stock 12,000 $ 60,000 12,000 $ 60,000 Series B Cumulative Convertible Preferred Stock 36,680 183,400 73,360 366,800 Series C Convertible Preferred Stock 1,905,882 324,000 1,905,882 324,000 Series E 8% Convertible Preferred Stock 50,000 250,000 - - --------- --------- ---------- --------- 2,004,562 $ 817,400 1,991,242 $ 750,800 ========= ========= ========== ========= Series A Convertible Preferred Stock In September, October and November 2001, the Company sold an aggregate 222,600 shares of $5.00 Series A Convertible Preferred Stock (Series A Preferred Stock) for total proceeds of approximately $1,113,000 through a Private Placement Memorandum. The Series A Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series A Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events. In December 2001, at the request of the holders of the Series A Preferred Stock, the Company and the individual holders modified the holding period for conversion to allow for conversion in December 2001. F-20 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note N - Preferred Stock Transactions - Continued Series A Convertible Preferred Stock - continued In September 2001, the Company's principal stockholder converted approximately $4,007,327 of unsecured debt and approximately $3,546,273 of cumulative and unpaid accrued interest into 1,510,710 shares of Series A Preferred Stock. In September 2001, a creditor of the Company agreed to convert approximately $10,000 of trade accounts payable into 2,000 shares of Series A Preferred Stock. In December 2001, concurrent with a modification in the holding period prior to conversion, certain holders of the Series A Preferred Stock orally notified the Company of their intent to exercise the conversion features on 1,749,720 issued and outstanding shares of Series A Preferred Stock into 19,246,920 shares of common stock prior to December 31, 2001. Due to the timing of the requisite documentation, the clerical activities related to this conversion were not completed until February 2002. In conjunction with the Series A Preferred Stock, certain shares were sold after the Company's common stock was approved for trading by the National Association of Securities Dealers on the OTC Bulletin Board in October 2001. The shares of Series A Preferred Stock sold subsequent to this date had an equivalent per share value of common stock below the ending quoted market price of the Company's common stock on their respective issue dates. This difference created a Beneficial Conversion Feature Discount of approximately $1,207,993. This discount was then amortized over the unexpired time period between the date of issue of the eligible shares and the eligible conversion date, as amended. All of the shares sold subsequent to the initial trading date were converted in December 2001 and, accordingly, the approximate $1,207,993 in Beneficial Conversion Feature Discount was fully amortized to operations. In December 2002, a holder of 5,000 shares of Series A Preferred Stock exercised his conversion rights and converted these shares of Series A Preferred Stock into 55,000 shares of restricted, unregistered common stock. In January 2003, three separate holders of 9,000 shares of Series A Preferred Stock exercised their conversion rights and converted these shares of Series A Preferred stock into 99,000 shares of restricted, unregistered common stock. Series B Convertible Preferred Stock In May 2003, the Company sold an aggregate 91,700 shares of $5.00 Series B Convertible Preferred Stock (Series B Preferred Stock) for total proceeds of approximately $458,500 through a separate Private Placement Memorandum. The Series B Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series B Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events. In September and December 2004, respectively, the Holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 18,340 shares of Series B Preferred Stock for 66,810 post-reverse split shares of restricted, unregistered common stock. F-21 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note N - Preferred Stock Transactions - Continued

Series B Convertible Preferred Stock On March 31, June 30, October 23, and December 27, 2006, respectively, the holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 36,680 shares (9,170 shares per conversion) of Series B Preferred Stock for 831,412 shares of restricted, unregistered common stock. Series C Convertible Preferred Stock In November 2004, the Company sold 1,905,882 shares of Series C Convertible Preferred Stock to an existing stockholder and officer of the Company in a private transaction pursuant to Section (4)2 of the Securities Act of 1933 for gross proceeds of approximately $324,000. No underwriter was used in conjunction with this transaction. The Series C Convertible Preferred Stock provides for dividends at a rate of 4.0% per annum, to be declared and paid monthly in either cash or stock at the discretion of the Company. Each share of Series C Preferred Stock is convertible at a rate of $0.18 per share into 1,800,000 shares of the Company's common stock at any time at the option of the holder, subject to adjustments for customary anti-dilution events. On March 1, 2006, the Company issued a Private Placement Memorandum offering up to 200,000 shares of 8% Convertible Preferred Stock at an offering price of $5.00 per share on a "best efforts" basis through an unrelated placement agent. Series E 8% Convertible Preferred Stock The Series E 8% Convertible Preferred Stock provides for cumulative dividends at the rate of 8% per year, payable quarterly, 50% in cash and 50% in shares or 100% in cash at the Company's election. In the event the Company elects to pay such dividends in shares of the Company's Common Stock, the number of shares to be issued shall be based on the average of the closing prices of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the Company's Common Stock is then traded) for the 10 consecutive trading days preceding the record date for each such dividend, with such record date being the 14th day preceding the end of each calendar quarter. Each share of Series E Convertible Preferred Stock shall be convertible into shares of the Company's Common Stock at any time after March 1, 2007. The number of shares to be issued on a conversion shall be based on 80% of the average closing price of the Common Stock of the Company; as reported on the NASDAQ OTC Bulletin Board (or such other market on which such stock is traded) for ten (!0) consecutive trading days preceding the date the Company received notice of such conversion. Subject to certain restrictions, the Series E 8% Convertible Preferred Stock shall automatically convert into shares of the Company's Common Stock upon any of the following events: (I) the sale by the Company of all or substantially all of its assets; (ii) the consummation of a merger or a consolidation in which the Company is not the survivor; or (iii) the sale or exchange of all or substantially all of the outstanding shares of the Company's common stock (including by way of merger, consolidation, or other similar action). In the event of the liquidation, dissolution or winding up of the Company, the holders of Series E Convertible Preferred Stock shall have a liquidation preference over holders of common stock and shares junior to the Series E 8% Convertible Preferred Stock equal to $5.50 per share. Additionally, the Company shall not impose or allow any additional liens on it's existing fixed assets in excess of $1,000,000; provided that at such time as total gross proceeds from F-22 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note N - Preferred Stock Transactions - Continued Series E 8% Convertible Preferred Stock - continued the offering equal or exceed $2,000,000, the Company shall satisfy such existing liens on its existing fixed assets and shall not impose or allow any additional liens on its existing fixed assets unless subordinated to the interest of the Series E 8% Convertible Preferred Stock, with such preference on the fixed assets equal to the fixed asset value, as determined in accordance with the United States Generally Accepted Accounting Principles ("GAAP"), of 150% of the stated value of the aggregate of the outstanding shares of Series E Convertible Preferred Stock except for fixed assets of the Company that were otherwise purchased pursuant to a security interest. The Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the Company, for cash in the amount of $5.50 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate, at any time after March 1, 2007, or in the event the closing sale price of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the Company's Common Stock is then traded), is greater than or equal to $7.00 after March 1, 2007 for any consecutive five trading days. In addition, the Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the holder, at any time for shares of the Company's Common Stock in accordance with the Conversion Rate. At any time after March 1, 2007, at the option of the holder, the Series E 8% Convertible Preferred Stock shall be redeemable for cash in the amount of $5.10 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate. After such date, if redemption is for cash, shares will be redeemed at the rate of 1/10 of such aggregate shares per quarterly period for any 10 consecutive quarters commencing after March 1, 2007. Any redemption by either the Company or the holder shall be subject to 15 days written notice. The Company warrants and agrees that if, at any time within the period commencing on the date of the final closing of the Offering and expiring on the 5th anniversary of the date thereof, the Company should file a registration statement with the SEC under the Securities Act (other than in connection with a merger or other business combination transaction or pursuant to Form S-8), it will give written notice at least 30 calendar days prior to the filing of each such registration statement to the holders of the Series E 8% Convertible Preferred Stock and the holders of the shares of the Common Stock issued upon the conversion or redemption of the shares of Series E Convertible Preferred Stock, or their permitted assigns (Holders) of its intention to do so. If the Holders notify the Company within 30 calendar days after receipt of any such notice of its or their desire to include any such shares of Common Stock issued or issuable upon the conversion or redemption of the Series E 8% Convertible Preferred Stock in such proposed registration statement, the Company shall use its "best efforts" to have any such shares of Common Stock is issued or issuable upon the conversion or redemption of the Series E 8% Convertible Preferred Stock registered under such registration statement. Notwithstanding the foregoing, the Company shall have the right at any time after it shall have given written notice (irrespective of whether a written request for inclusion of any such securities shall have been made) to elect not to file any such proposed registration statement, or to withdraw the same after the filing but prior to the effective date thereof. If the managing underwriter of an offering to which the above "piggyback registration rights" apply, in good faith and for valid business reasons, objects to such rights, such objection shall preclude such inclusion. All expenses incurred by the Company in registration of the shares of Common Stock issued or issuable upon the F-23 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note N - Preferred Stock Transactions - Continued Series E 8% Convertible Preferred Stock - continued conversion or redemption of The Series E 8% Convertible Preferred Stock, including with out limitation all registration and filing fees, listing fees, printing expenses, fees and disbursements of all independent accounts, or counsel for the Company and the expense of any special audits incident to or required by any such registration and the expenses of complying with the securities or blue sky laws of any jurisdiction shall be paid by the Company. The Company has agreed to pay the Placement Agent a cash commission equal to 10% of the aggregate Purchase Price of the shares of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Fee). The Company shall also pay the Placement Agent reasonable expenses associated with the Offering, which expenses shall not exceed $50,000 (Expense Allowance). In addition, the Company shall issue to the Placement Agent 500 warrants for each $50,000 of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Warrants), each warrant entitling the holder to purchase 1 share of the Company's Common Stock at an exercise price of $0.90 per share exercisable at any time for a period of 3 years from date of issuance. Upon completion of the Maximum Offering, the Company will receive net proceeds of approximately $900,000.00. The Company intends to use the net proceeds for potential acquisitions, working capital, general corporate purposes and repayment of outstanding debt. The Company and the Placement Agent shall have discretion to increase the Maximum Offering to $2,000,000.00, without notice to investors.. Through June 30, 2006, the Company sold 100,000 shares in a two separate transactions under this Private Placement Memorandum and has received the gross sales proceeds of $500,000 and has paid an aggregate of $50,000 to the Placement Agent for the 10% fees due on these transactions. On September 13, 2006, the Company exercised it's repurchase rights and retired 50,000 shares of the Series E 8% Convertible Preferred Stock, including a 10% prepayment penalty, for $275,000 cash. Note O - Common Stock Transactions On January 9, 2006, by written consent in lieu of meeting, a majority of the Company's stockholders approved a recommendation by the Company's Board of Directors to effect a one share for twenty shares reverse stock split of our common stock, par value $.001 per share, with fractional shares rounded up to the nearest whole share. The reverse split became effective on that date. As a result of the reverse split, the total number of issued and outstanding shares of the Company's common stock decreased from 92,576,839 to 4,629,381shares, after giving effect to rounding for fractional shares. The effect of this action is reflected in the Company's financial statements as of the first day of the first period presented. In conjunction with the above discussed reverse stock split, all share references in the following paragraphs reflect the January 9, 2006 reverse split action. F-24 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note O - Common Stock Transactions Calendar 2005 Transactions On various dates between June 28, 2005 and August 10, 2005, the Debenture Holder elected to convert an aggregate $40,000, through 4 separate transactions, in outstanding Debenture principal into registered common stock. This election caused the Company to issue 293,602 shares of common stock to the Debenture Holder. Additionally, pursuant to the contract terms, the Debenture Holder concurrently exercised a portion of the outstanding Warrant to purchase 400,000 shares of the Company's common stock for gross proceeds of $400,000. In September and December 2005,respectively, the Holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 18,340 shares of Series B Preferred Stock for 66,810 shares of restricted, unregistered common stock. In July 2005, the Company issued approximately 8,333 shares of unregistered, restricted common stock to Paul Goebel, the Company's former Director of Domestic Sales, as an employee bonus. These shares were valued at approximately $17,166, which approximated the market value of the shares on the transaction date. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. In February, August, September and December 2005, the Company issued an aggregate 23,615 shares of restricted, unregistered common stock in payment of approximately $44,124 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarters ended December 31, 2004, March 31, 2005, June 30, 2005, September 30, 2005 and December 31, 2005, respectively. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. In August, November and December 2005, respectfully, the Company issued an aggregate 37,500 shares of restricted, unregistered common stock to an existing shareholder as payment of various fees and costs associated with the funding of approximately $875,000 short-term working capital loans to the Company. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. Calendar 2006 Transactions In February 2006, the Company issued approximately 41,666 shares of unregistered, restricted common stock to Paul Goebel, the Company's Director of Domestic Sales, as an employee bonus. These shares were valued at approximately $17,500, which approximated the market value of the shares on the transaction date. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. F-25 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note O - Common Stock Transactions Calendar 2006 Transactions - continued In February 2006, the Company issued approximately 226,065 shares of restricted, unregistered common stock, valued at approximately $18,325, to an existing stockholder as for payment of accrued interest associated with approximately $875,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately $70,080 on this transaction. In May 2006, the Company issued approximately 266,511 shares of restricted, unregistered common stock, valued at approximately $21,054, to an existing stockholder as for payment of accrued interest associated with approximately $975,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately $69,293 on this transaction. In September 2006, the Company issued approximately 275,229 shares of restricted, unregistered common stock, valued at approximately $22,018, to an existing stockholder as for payment of accrued interest associated with approximately $975,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately $118,348 on this transaction. In December 2006, the Company issued approximately 284,168 shares of restricted, unregistered common stock, valued at approximately $22,733, to an existing stockholder as for payment of accrued interest associated with approximately $975,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately $90,934 on this transaction. F-26 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note O - Common Stock Transactions Calendar 2006 Transactions - continued On March 31, June 30, October 23, and December 27, 2006, respectively, the holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 36,680 shares (9,170 shares per conversion) of Series B Preferred Stock for 831,412 shares of restricted, unregistered common stock. On September 13, 2006, the Company issued 56,003 shares of common stock to La Jolla Cove Investors, Inc. to complete all obligations to La Jolla and assign any and all of La Jolla's right, title and interest in any and all of the Company's indebtedness to La Jolla and specifically including La Jolla's rights under the active SB-2 Registration Statement for the issuance and registration of securities thereunder; the consent of the Company to the foregoing subject to the right of the Company to prepay any and all indebtedness thereunder in the Company's common stock, without penalty, at any time before or after default to La Terraza Trading and Asset Management, Inc. In July, August and October 2006, in three separate transactions, the Company issued an aggregate 50,135 shares of restricted, unregistered common stock in payment of approximately $19,177 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarters ended March 31, June 30 and September30, 2006, respectively. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. On December 27, 2006, effective as of September 13, 2006, the Company and La Terraza agreed that all pertinent conditions had been met and the Company released the aforementioned 11,470,000 shares of common stock issued pursuant to the Company's active Registration Statement on Form SB-2 to La Terraza in exchange for the previous receipt of approximately $2,150,000 in cash proceeds, the use of which has previously be discussed. The Company paid placement fees of approximately $215,000 in connection with the sale of these securities and the retirement of the La Jolla convertible debentures. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately $3,704,810 on this transaction. On December 27, 2006, the Company issued an additional 5,333,335 shares of common stock to La Terraza for gross proceeds of approximately $1,000,000. The Company paid placement fees of approximately $100,000 in connection with the sale of these securities. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately $1,136,000 on this transaction. F-27 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note P - Stock Warrants In conjunction with the Company's Private Placement Memorandum for the sale of Series E Convertible Preferred Stock, the Company agreed to issue to the Placement Agent warrants to purchase up to 500 shares of the Company's common stock for each $50,000 of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Warrants), each warrant entitling the holder to purchase 1 share of the Company's Common Stock at an exercise price of $0.90 per share exercisable at any time for a period of 3 years from date of issuance. On September 6, 2006, in conjunction with the $2,150,000 Financing Agreement with La Terraza, the Company issued warrants to purchase 600,000 shares of common stock at the lesser of $0.1875 per share or the average closing price per share for the Company's common stock over the twelve (12) month period prior to the date of such exercise, with the warrants being exercisable at any time from the issue date through July 24, 2011. The following table presents warrant activity through December 31, 2006: Weighted Average Number of Exercise Shares Price ----------- ----------- Balance at January 1, 2005 2,663,650 $ 1.00 Issued - - Exercised (40,000) $ 1.00 Expired - - ----------- ------------ Balance at December 31, 2005 2,263,650 $ 1.00 Issued Placement agent warrants 1,000 $ 0.90 La Terraza warrants 600,000 $ 0.1875 Exercised - - Expired (2,263,650) $ 1.00 ---------- ----------- Balance at December 31, 2006 601,000 $ 0.1887 ========= =========== Note Q - Rental Commitments The Company leases its corporate office and manufacturing facility from its controlling stockholder under a long-term operating lease agreement. The lease requires a monthly payment of approximately $5,735, including applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on December 1, 2009 and contains a clause that upon expiration, the Company and the controlling shareholder shall renegotiate the annual rental amount. The Company's subsidiary, IPE, leases it's manufacturing facility from an unrelated third-party under a long-term operating lease agreement. This lease is for a period of five (5) years and requires graduated monthly payments, changing on the lease anniversary date, ranging from approximately $1,751 to $1,914, plus the applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on February 28, 2007 and may be renewed F-28 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note Q - Rental Commitments - Continued for an additional five (5) year term at a rental rate of approximately $1,971, plus applicable sales taxes for the first renewal year and 3.0% increase on each succeeding anniversary date. Total rent expense under this lease was approximately $23,057 and 22,176, respectively, for each of the years ended December 31, 2006 and 2005. In May 2004, the Company entered into a long-term lease agreement for a warehouse facility adjacent to the Company's primary office and manufacturing facility. This lease was for a period of two (2) years and required payments of approximately $6,206 per month for the first 12 months and approximately $6,393 for the second 12 months, plus applicable sales taxes. The Company was responsible for all utilities and maintenance expenses. This lease expired on May 31, 2006 and the Company has no further responsibility under this lease agreement. Future minimum rental payments on the above leases are as follows: Year ended December 31, Amount ------------ ---------- 2007 $ 72,643 2008 68,815 2007 68,815 ---------- Totals $ 210,273 ========== For the respective years ended December 31, 2006 and 2005, the Company paid an aggregate of $125,862 and $158,947 in rent under these agreements. Note R - Income Taxes The components of income tax (benefit) expense for the years ended December 31, 2006 and 2005, respectively, are as follows: Year ended Year ended December 31, December 31, 2006 2005 -------------- ---------------- Federal: Current $ - $ - Deferred - - ------- ------ - - ------- ------ State: Current - - Deferred - - ------- ------ - - ------- ------ Total $ - $ - ====== ====== As of December 31, 2006, the Company has a net operating loss carryforward of approximately $14,500,000 to offset future taxable income. Subject to current regulations, components of this carryforward began to expire in 2005. The amount and availability of the net operating loss carryforwards may be subject to limitations set forth by the Internal Revenue Code. Factors such as the number of shares ultimately issued within a three year look-back period; whether there is a deemed more than 50 percent change in control; the applicable long-term tax exempt bond rate; continuity of historical business; and subsequent income of the Company all enter into the annual computation of allowable annual utilization of the carryforwards. F-29 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note R - Income Taxes - Continued The Company's income tax expense (benefit) for the years ended December 31, 2006 and 2005, respectively, differed from the statutory federal rate of 34 percent as follows: Year ended Year ended December 31, December 31, 2006 2005 -------------- ---------------- Statutory rate applied to loss before income taxes $ (2,840,000) $ (2,062,600) Increase (decrease) in income taxes resulting from: State income taxes - - Non-deductible items Impairment of recoverability of carrying value of fixed assets - 944,000 Imputed interest on derivative liability from warrants and convertible notes 157,000 42,600 Compensation expense related to common stock issuances at less than "fair value" 1,765,000 87,000 Other, including reserve for deferred tax asset 918,000 989,000 -------------- -------------- Income tax expense $ - $ - ============== ============== Temporary differences, consisting primarily of the net operating loss carryforward and statutory differences in the depreciable lives for property and equipment, between the financial statement carrying amounts and tax bases of assets and liabilities give rise to deferred tax assets and liabilities as of December 31, 2006 and 2005, respectively: Year ended Year ended December 31, December 31, 2006 2005 ------------ ------------ Deferred tax assets - long-term Net operating loss carryforwards $ 4,930,000 $ 4,080,000 Deferred tax liabilities - long-term Statutory depreciation differences (500,000) (525,000) ------------ ------------ 4,430,000 3,555,000 Less valuation allowance (4,430,000) (3,555,000) ------------ ------------ Net Deferred Tax Asset $ - $ - ============ ============ During the years ended December 31, 2006 and 2005, respectively, the valuation allowance increased (decreased) by approximately $875,000 and $1,576,000. [Balance of this page intentionally left blank.] F-30 AMERICAN AMMUNITION, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED December 31, 2006 and 2005 Note S - Revenue Concentrations The

Company sells to both commercial and governmental customers, in both domestic and foreign markets. The following table shows the Company's gross revenue composition: Year ended Year ended December 31, 2006 December 31, 2005 ----------------- ----------------- Amount % of total Amount % of total ---------- ---------- ---------- ---------- Domestic Commercial Customer A $ 713,429 31.83 $ 222,272 6.85 Others 1,140,334 50.88 958,813 29.56 ---------- ---------- ---------- ---------- 1,853,762 82.71 1,181,085 46.41 ---------- ---------- ---------- ---------- Private Label 268,129 11.96 407,063 12.55 ---------- ---------- ---------- ---------- Governmental Customer B 51,089 2.28 541,392 16.69 Customer C - - 399,860 12.33 Others 10,256 0.46 44,963 1.39 ---------- ---------- ---------- ---------- 61,345 2.74 986,215 30.41 ---------- ---------- ---------- ---------- Foreign Governmental Customer D - - 644,180 19.86 Others 58,163 2.59 25,090 0.77 ---------- ---------- ---------- ---------- 58,163 2.59 669,270 20.63 ---------- ---------- ---------- ---------- Totals $2,241,399 100.00 $3,243,633 100.00 ========== ========== ========== ========== [Balance of this page intentionally left blank.] (Signatures follow on next page) F-31 SIGNATURES In accord with Section 13 or 15(d) of the Securities Act of 1933, as amended, the Company caused this report to be signed on its behalf by the undersigned, thereto duly authorized. American Ammunition, Inc. Dated: October , 2007 By: /s/ Andres F. Fernandez ------------------ ---------------------------------- Andres F. Fernandez President, Chief Executive Officer, Chief Financial Officer and Director In accordance with the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the date as indicated. Dated: October , 2007 By: /s/ Andres F. Fernandez ------------------ ---------------------------------- Andres F. Fernandez President, Chief Executive Officer, Chief Financial Officer and Director Dated: October , 2007 By: /s/ J. A. Fernandez, Sr. ------------------ ------------------------------------ J. A. Fernandez, Sr. Chairman, Director of Sales, and Director Dated: October , 2007 By: /s/ Emilio D. Jara ------------------ ----------------------------- Emilio D. Jara. Vice President - Operations, Corporate Secretary and Director Dated: October 19, 2007 By: /s/ Maria A. Fernandez ------------------ --------------------------------- Maria A. Fernandez, Director 58