SPACEHAB INC \WA\
Form 10-K
September 21, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the fiscal year ended June 30, 2007
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to

Commission File No. 0-27206

SPACEHAB, Incorporated

(Exact name of registrant as specified in this charter)

Washington	**91-1273737**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

12130 Highway 3, Building 1

Webster, Texas 77598-1504

(Address of principal executive offices) (Zip code)

(713) 558-5000

(Registrant s telephone number, including area code)

Securities Registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock (no par value)	**NASDAQ Capital Market**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO x

The aggregate market value of the registrants voting and non-voting common equity held by non-affiliates of the registrant, based upon the closing price of such stock on the NASDAQ National Market on such date of $0.65 was approximately $8,429,242 as of December 29, 2006.

As of September 19, 2007, 13,027,196 shares of the registrant s Common Stock, no par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Information called for in Part III of this Form 10-K is incorporated by reference to the registrant s definitive Proxy Statement to be filed within 120 days after the end of the registrant s fiscal year in connection with the registrant s annual meeting of shareholders.

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FORWARD-LOOKING STATEMENTS

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical fact are forward-looking statements for purposes of federal and state securities laws. Forward-looking statements may include the words may, will, plans, believes, estimates, expects, intends and similar expressions. Such statements are subject to risks and uncertainties that could cause our actual results to differ materially from those projected in the statements. Such risks and uncertainties include, but are not limited to:

- Our ability to raise sufficient capital to meet our long and short-term liquidity requirements;
- Our ability to successfully pursue our business plan;
- Uncertainty about our future liquidity;
- Whether we will fully realize the economic benefits under our NASA and other customer contracts;
- Completion of the International Space Station, and the continued availability and use of the U.S. Space Shuttle and the International Space Station;
- Technological difficulties and potential legal claims arising from any technological difficulties;
- Product demand and market acceptance risks, including our ability to develop and sell products and services to be used by the manned and unmanned space programs that replace the Space Shuttle Program;
- The effect of economic conditions in the U.S. or other space faring nations that could impact our ability to access space and support or gain customers;
- Uncertainty in government funding and support for key space programs;
- The impact of competition on our ability to win new contracts;
- Delays and uncertainties in future space shuttle and the International Space Station programs;
- Uncertainty in securing reliable and consistent access to space;
- Delays in the timing of performance of other contracts; and
- Risks described in the Risk Factors section of this Form 10-K.

Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could be inaccurate, and, therefore, we cannot assure you that the forward-looking statements included in this Form 10-K will prove to be accurate. In light of the significant uncertainties inherent in our forward-looking statements, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Some of these and other risks and uncertainties that could cause actual results to differ materially from such forward-looking statements are more fully described under the heading Risk Factors beginning on page four of this Form 10-K and elsewhere in this Form 10-K, or in the documents incorporated by reference herein. Except as may be required by applicable law, we undertake no obligation to publicly update or advise of any change in any forward-looking statement, whether as a result of new information, future events or otherwise. In making these statements, we disclaim any obligation to address or update each factor in future filings with the SEC or communications regarding our business or results, and we do not undertake to address how any of these factors may have caused changes to discussions or information contained in previous filings or communications. In addition, any of the matters discussed above may have affected our past results and may affect future results, so that our actual results may differ materially from those expressed in this Form 10-K and in prior or subsequent communications.

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PART 1

DEFINITIONS

As used in this Form 10-K, the abbreviations and acronyms contained herein have the meanings set forth below. Additionally, the terms SPACEHAB , the Company , we , us and our refer to SPACEHAB, Incorporated and its subsidiaries, unless the context clearly indicates otherwise.

1994 Plan	1994 Stock Incentive Plan
AAC	Applied Astronautics Corporation
APB	Accounting Principles Board
ASO	Astrotech Space Operations
Astrium	Astrium GmbH
Astrotech	Astrotech Space Operations
ATV	Automated Transfer Vehicle
Boeing	The Boeing Company
CE&R	Concept Exploration and Refinement
Common Stock	SPACEHAB Common Stock
ESP2	External Stowage Platform 2
ESP3	External Stowage Platform 3
FASB	Financial Accounting Standards Board
Flight Services	SPACEHAB Flight Services
GAAP	Generally Accepted Accounting Principles
Government Services	SPACEHAB Government Services, Inc.
ICC	Integrated Cargo Carrier
ISS	International Space Station
IVA	Intravehicular Activity
JAXA	Japan Aerospace Exploration Agency
Lloyd s	Lloyd s of London
Lockheed Martin	Lockheed Martin Corporation
NASA	National Aeronautics and Space Administration
OSTM	Ocean Surface Topography Mission
PI&C	Program Integration and Control
RDM	Research Double Module
ReALMS	Research and Logistics Mission Support
RSC Energia	Rocket Space Corporation-Energia
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SMI	Space Media, Inc.
SMI Plan	Space Media, Inc. Stock Option Plan
USAF	United States Air Force

Item 1. Business.

Our Company

We were incorporated as a Washington corporation in 1984. We provide a range of products and services that focus on the needs of industry, governments and academia requiring access to, and utilization of the unique environment of space. We employ a staff of engineers and technicians who have supported approximately 250 manned and unmanned missions to space from multiple locations worldwide, including 23 space shuttle missions. We offer products and services in the following areas:

- Expertise in qualifying hardware for spaceflight and the habitability and occupational challenges of space;
- Facilities and support services necessary for the preparation of satellites and payloads for launch;
- Engineering, analysis, and payload operations services;
- Program integration and control; and
- Product design, development, and fabrication.

Our Business Units

Our company is currently comprised of three primary business segments which provide the following products and services to the government and commercial markets. Our business units include:

SPACEHAB Flight Services. The primary goal of our Flight Services business unit is to enable government and commercial enterprises to overcome the accessibility, habitability and occupational challenges of space. To meet our clients specific mission requirements, we offer a range of engineering, research, logistics, integration, operations, and ground support services. Through this business unit, we will continue to offer a full range of ground-based pre- and post-flight experiment, cargo, and payload processing services as well as on-orbit operations support. Additionally, we are supporting contracts for ongoing flight hardware manufacturing projects in support of NASA and international customers. During fiscal year 2007, our Flight Services business unit accounted for 65% of our consolidated revenues.

Astrotech Space Operations. Our Astrotech business unit provides modern facilities and support for the preparation of multi-million dollar satellites and payloads for launch on expendable launch vehicles. Since 1985, our Astrotech business unit has been providing government and commercial customers with a commercial alternative to using government-owned facilities to prepare their satellites for launch in the United States. Astrotech currently has long-term contracts in place with NASA, United Launch Alliance, National Reconnaissance Office and Sea Launch, LLC. During fiscal year 2007, Astrotech accounted for 23% of our consolidated revenues.

SPACEHAB Government Services. For nearly 30 years, our Government Services business unit has provided large scale program technical support and specialized engineering analysis, products, and services to NASA and other customers. Our Government Services business unit derives most of its revenue under ARES contract to provide configuration and data management services within NASA s Program Integration and Control contract for the International Space Station. The base contract period extends through September 2008 and can be extended for two additional one year terms at the election of our NASA customer. Under this contract, we facilitate the assurance that the tens of thousands of hardware and software parts and components meet approved design and the configuration requirements for the International Space Station. During fiscal year 2007, our Government Services business unit accounted for 11% of our consolidated revenues.

Short-Term Liquidity Issues

Until August 2007, our primary source of revenues and cash flows was our Flight Services unit. This business unit represented 65% of our consolidated revenues during fiscal year 2007. For the reasons discussed below, in August, the Company completed its last designated space shuttle mission employing modules. We have written off the book value of these space assets and have terminated our leases on certain other space shuttle assets. As a result, a substantial component of historical revenue and cash flow will not be achieved in future periods.

We currently have $10,306,000 of Junior Notes which mature in October 2007 and $52,944,000 of Senior Notes which mature in October 2010. If we do not consummate our proposed exchange offer (see Note 27 of our audited consolidated financial statements), we do not anticipate that we will be able to make the principal payments due on our Junior Notes in October 2007 without additional financing.

New Business Vision

In anticipation of the planned 2010 space shuttle retirement, we began developing new products and services. We are now focusing our business on applying our core capabilities for the commercial exploitation of space. These new business initiatives include the following:

- Processing products and services in microgravity;
- Commercializing products manufactured in microgravity;
- Commercializing products developed for use in the space industry;
- Acquiring other U.S. space contractors; and
- Providing end-to-end services for commercial and government satellite operations.

Although we are developing products and services in support of the new business vision, we currently do not have contracts or other arrangements to provide these products and services. We cannot assure you that we will be able to successfully develop these new products and services in the future. We anticipate that we will require substantial additional capital to develop these new products and services, and that this additional financing will likely substantially dilute current holders of our common stock.

The following is a summary of our new business initiatives.

Microgravity

Overview. In the early days of the space program, it was determined that the effects of microgravity provided a unique environment that could potentially benefit humans. Over the life of the space shuttle and International Space Station programs, NASA has spent billions of dollars on microgravity infrastructure and research experiments in order to understand these effects. Many of these products and services have not been developed and we have been responsible for the logistics for several hundred of these experiments on the space shuttle, the Russian Progress vehicle, the Mir Space Station, and the International Space Station.

On August 14, 2007, in an announcement that we believe bolsters the development of our microgravity business, NASA stated that it was seeking private industry proposals for research and manufacturing concepts and opportunities onboard the International Space Station. This announcement, along with Congress designation of the International Space Station as a National Laboratory, indicates NASA s desire to open the International Space Station for the benefit and profit of commercial projects. Because of our experience with microgravity, believe that we are well positioned to transition from handling the logistics of microgravity research projects to a fully commercialized microgravity design, transportation and processing operation.

Microgravity Mission Design Initiative. Based upon our microgravity logistics experience, we expect to prepare and send complex processing facilities to space. This end-to-end service requires our core capabilities including:

- Payload analysis;
- Process and control analysis;
- Product design;
- Flight hardware manufacturing;
- Hardware test and certification;
- Robotic facility development;
- Payload containment systems;
- Data communication systems; and
- Safety analysis and certification.

Microgravity Transportation Initiative. SPACEHAB microgravity transportation will encompass the planning and preparation of microgravity payloads for installation and launch on a variety of launch systems including the space shuttle, Russian Soyuz, Progress and Photon, European ATV, Japanese HTV, our planned ARCTUS spacecraft, the SpaceX Corporation s Dragon and Rocketplane Kistler s K-1. These preparations will include preparing complex life science and material processing payloads to survive the extremities and complexities of a launch to microgravity. We expect to provide specialized transportation of payloads to the launch site and integrate payloads into the launch vehicle. Returning payloads will then be recovered at the landing site where our personnel will remove the payload and transport it to the post processing destination.

Microgravity Processing Initiative. As part of our microgravity processing initiative, we have analyzed the results of a number of the experiments that we were logistically responsible for on the space shuttle, the Russian Progress vehicle, the Mir Space Station, and the International Space Station. We have targeted potential products that we believe can be developed in microgravity, that are within our core capabilities and that we believe provide proven value. In anticipation of this function, our Logistics Training Module, located at the SPACEHAB Payload Processing Facility in Cape Canaveral Florida, is being retrofitted as a training facility for applications under our new microgravity processing initiative. We believe that this training facility will assist us with executing the very complex in-space processing procedures that will be necessary for us to successfully produce products developed in microgravity that are capable of being commercialized. In addition, we expect to also improve upon microgravity processing hardware, software, and production techniques to further improve our on-orbit processing capabilities and results. This includes remote process controls, robotics, data communications and flight hardware design and certification.

SPACETECH Initiative. In 2007, SPACETECH was formed to serve as a technology incubator . Through SPACETECH, we intend to commercialize products that we plan to produce in microgravity, secure the rights to and commercialize hardware and software designed for and used in space, and manufacture, sell, and distribute the end product to government and commercial consumers. SPACETECH has identified the following products that are in various stages of their product life cycles:

- Under a Space Act Agreement with NASA, we began development of a mini-mass spectrometer, a small, portable, low power unit capable of detecting chemical compounds such as explosives, weapons of mass destruction, and toxic gases. We believe that this new ion trap technology will have many commercial terrestrial applications including Homeland Security applications such as airport, shipping port, and border control; medical applications including anesthesia expelled gas analysis and medicine production and contamination detection; chemical applications including polymer process control; and food processing applications which include process control, contamination, and spoil detection. Mockups of our mini-mass spectrometer have been tested and we are currently refining the design for commercial manufacturing. We are currently in negotiations with a company relating to the licensing, sales and distribution of the mini-mass spectrometer.

- The Federal Aviation Administration and Department of Transportation have enacted new regulations for airline transportation of oxygen containers to enhance safety in the event of a fire. Applying decades of experience in the development of specialized containers, we are working with an industry partner to develop and certify a container to meet these new requirements. Early testing has proven successful. If we are successful in developing this product, we may have an opportunity to enter a new market.

- With our many years of experience in human spaceflight, we became aware of various persistent problems regarding cargo transportation to and from Earth. One such problem is the containment of liquids in commonly used soft bag containers. These soft bags are widely used over hard containers due to the lighter weight materials they are constructed from and the need for more flexible materials that allow more efficient packing configurations. The inherent problem with soft bags is the difficulty in keeping them water tight in the microgravity environment and in such extreme conditions such as launch and reentry. The SPACEHAB Containment Bag was successfully designed and developed and flew its first mission on STS-118. We are in the process of having this product flight qualified for use by NASA on future space flights. We believe that this technology can also be used in Earth-based applications such as hazardous waste containment, bio-hazard containment, environmental clean-up operations, medical transportation applications, disaster recovery operations, and military applications.

- Beginning with STS-9, NASA conducted numerous microgravity research projects related to protein crystal growth in space. However, due to the realignment of NASA s goals, there are no further NASA-sponsored protein crystal growth efforts planned. Through the execution of our microgravity processing initiative, we expect to take full advantage of the microgravity protein crystal growth findings and infrastructure established by NASA. Protein

crystals lead to the development of treatments that target diseases caused by aberrant protein function. Previous spaceflight research suggests that growing protein crystals in the microgravity environment of space offers the possibility of significantly increasing the x-ray diffraction quality of protein crystals. We believe that because of the high quality of these protein crystal structures, they may be used to better define the protein structures of diseases such as diabetes, cystic fibrosis, sickle cell anemia, Alzheimer s, Parkinson s disease, Lou Gehrig s disease and certain forms of cancer, which in turn may lead to the development of drugs capable of combating these diseases. If we are successful in developing protein crystals in microgravity, we expect to pre-sell these crystals to pharmaceutical companies.

- Among the many life science experiments that were flown in our science module were tissue growth cultures. Spaceflight results suggested that skin grown under microgravity conditions has the potential for being utilized more effectively in skin grafting therapies. This is important for many medical applications including burn victims that would greatly benefit from the more complete tissue that can be grown in the microgravity environment of the International Space Station. We will attempt to establish relationships with therapeutic companies in the sales and distribution of product related to this initiative.

New Astrotech Services

We believe that Astrotech is a recognized leader in commercial spacecraft processing services. Astrotech intends to expand its market by offering end-to-end assurance services to both commercial and government customers. These new services would extend Astrotech s current relationships with customers satellites from a few weeks of ground processing to multiple years of services throughout a satellite s lifecycle. Specifically, we believe that there are hundreds of commercial and government satellites that could each be served for 10 years or longer by Astrotech s new end-to-end space mission assurance services. We have been and will continue to research, along with our government and commercial customers, the capability to provide a wide range of on orbit services that includes the capability to provide additional station time, fleet management services, surveillance systems, and de-orbit services. The pursuit of these new offerings is expected to increase Astrotech revenue dramatically, but may require Astrotech to invest in new terrestrial and orbital capabilities.

New SPACEHAB Engineering Services Contracts

Our exceptional performance under the Program Integration and Control contract, including the government awarding us a perfect score of 100, led to us securing a contract for additional configuration and data management work in support of NASA s Constellation Program. Additionally, we are currently responding to formal requests for proposals for similar support on the Orion Project Integration Contract and the Constellation Program Support Contract.

New Flight Services Initiatives

The primary goal of our Flight Services business will be to provide government and commercial customers the same quality mission design flight hardware design and fabrication, and payload integration services that we have performed for NASA for the past 23 years. We expect launch providers to use these services because of our experience in this area and the complexity in preparing cargo for launch.

Advanced Research and Conventional Technology Utilization Spacecraft (ARCTUS)

We are assembling a team of industry partners with the common goal of developing a commercial transportation system providing lower cost, lower risk space transportation services, than conventional government-developed transportation systems. ARCTUS is designed to provide cargo transportation services to the International Space Station under the unfunded Space Act Agreement signed with NASA in June 2007. The ARCTUS design uses flight-proven components to reduce development costs and program risk. This approach eliminates a large percentage of most of the non-recurring engineering labor costs. The ARCTUS design is expected to be compatible with existing, flight-proven launch vehicles, payload requirements, and interfaces, as well as the interface requirements for vehicles visiting the International Space Station. If completed, we believe that ARCTUS will be able to provide us with an additional space access solution for our microgravity processing products and for commercial cargo delivery to the International Space Station.

Our Competitive Strengths

We believe that during our 23 year history, we have developed specialized experience in providing space products and services. We believe that it is this solid foundation, along with the following competitive strengths, that will enable us to achieve our business strategy:

- *Industry-unique Expertise*. We have completed 23 space shuttle missions, prepped nearly 250 satellites for launch, and been responsible for the logistics of experiments flown in space. We are the only commercial company that designed and flew habitable volume for use by the space shuttle crews as additional living and working space. Further, the ability to integrate products into a variety of containers and ultimately, vehicles, is a significant competitive advantage for us.

- *Employees*. From five locations nationwide, our team is comprised of highly specialized personnel closely familiar with both the space industry and/or governmental space agencies who have special expertise in commercial space and human space flight.

- *Government Services Achievement*. We have become highly valued for our support of the International Space Station configuration and data management requirements as evidenced by our receipt of a perfect award score of 100 and near perfect scores during subsequent evaluation periods.

- *Recognizable and Respected Brand*. We believe the SPACEHAB name and mark is one of a select few brands that has appeared in countless media photos and video footage featuring on orbit activities and crew members in action on the space shuttle.

Competition

Our competition and the barriers to entry vary amongst our business units. For our Flight Services segment, the modules and other assets that we own represent a capital investment that many new entrants into the market would have difficulty matching. Although our modules are currently not scheduled for use on another space shuttle mission, we estimate that it would take another organization three to five years to develop, and certify for use by NASA, a module service similar to that operated by our Flight Services business unit. NASA has elected to utilize competing government-developed systems (i.e. the Italian Space Agency-built Multi Purpose Logistics Module, etc.) for the remaining logistics requirements. However, we believe our assets provide more utility in supporting powered experiments and are able to carry more weight and volume than the other solutions available to NASA.

A robust commercial space industry is developing with SpaceX and RpK achieving grants in 2006 under the COTS Space Act Agreement (SAA) to develop commercial based cargo capability and other competitors such as SpaceDev, Andrews Aerospace, ourselves, and others continuing with developing alternatives under unfunded SAAs. In September, the Company and several other commercial space companies responded to NASA s Request for Information (RFI) for Phase II commercial ISS cargo transportation services. NASA s stated goal was to use responses from the RFI to help craft a formal solicitation for these services, however there is no guarantee that a solicitation will be issued. NASA has also committed to utilize the Russian Progress and Soyuz vehicles to supplement and replace capability of the space shuttle as it is phased out. The European ATV and Japanese HTV will also provide alternatives to NASA and commercial uses as access to space.

We expect that our space based microgravity processing will compete with both foreign and domestic institutional supported research from governments and academia.

Our Astrotech spacecraft and payload processing facilities are located in Florida and California and process satellites constructed in the United States. Due to the costs of transporting spacecraft internationally, our Astrotech business unit generally does not compete with launch services based in other countries. At present, our Astrotech business unit s commercial U.S. competition is limited to the California launch site at Vandenberg Air Force Base where California Commercial Spaceport Systems International (SSI) is located. SSI acquired surplus United States Air Force (USAF) facilities through a lease agreement with the USAF at Vandenberg Air Force Base before we established our facilities there. SSI does not have payload processing facilities in Florida, where the majority of U.S. commercial satellite launches occur. In addition, as the commercial space industry continues to evolve, we expect to face increasing competition from new companies. Our new initiative in end to end mission assurance capabilities faces the competitors of OSSL in Europe, GEORing in Europe, the U.S. military, NASA, and other government funded on orbit servicing entities.

NASA previously instituted a policy that required Agency spacecraft programs to utilize commercial payload processing facilities for all missions that do not have a nuclear power source or planetary protection requirement. As stated in NASA s Commercialization Plan issued in August 2006, a trade study was recently performed, comparing commercial facilities, such as SPACEHAB s Astrotech campus, with government-owned facilities. The study also reexamined the policy of using mostly commercial payload processing services at the Kennedy Space Center. NASA concluded that it was in the Agency s best interest to continue the current policy of using commercial facilities for nominal payload processing.

Our Government Services business unit competes with companies that provide operations support, configuration management, and engineering and fabrication services to NASA. These competitors include aerospace contractors such as Boeing, Lockheed Martin, United Space Alliance, ARES Corporation, Barrios Technologies Inc., Bastion Technologies, Cimarron, and Oceaneering Space Systems. However, this business unit s primary source of revenue comes from a subcontract arrangement that expires in 2008 with options to extend up to two years.

We expect SPACETECH to develop and market new products, based upon space technologies. This new initiative s two primary business development efforts are the mini-mass spectrometer and the plane box specialized container. Competition to the mini-mass spectrometer will come in two forms: incumbent mass spectrometer companies (i.e., Griffin Analytical, Torion, and Inficon) and new competing technologies (Smiths Detection, GE Security, and OI Analytical). SPACEHAB s design incorporates an approach which we expect to lead to a lower cost and higher volume capacity than our competitors. We expect the competition for our plane box product will be minimal given that the container is being designed in response to a new DoT and FAA rule. One potential competitor, Viking Packaging, began pursuing the opportunity but has since halted the project as their concept encountered issues during preliminary testing. Currently we are not aware of any competitors. However, large companies with greater capital resources may enter this field.

Dependence on a Single Customer or Limited Number of Customers

Approximately 75% of our revenue in fiscal year 2007 was generated by various NASA contracts or subcontracts. While other contracts with commercial customers provide revenue from varying sources, we anticipate that contracts servicing NASA will continue to account for a significant amount of our revenue in the near future. Although we cannot make any assurances that NASA will require our services in the future, we are under firm contracts with NASA to support a variety of activities for the next several years. We continue to work on diversifying our customer base to include other government agencies, foreign space agencies, aerospace partners, and private companies.

Similar to contracts with other agencies of the U.S. Government, our contracts servicing NASA contain provisions pursuant to which NASA or the prime contractor may terminate the contract for convenience. Our contracts servicing NASA depend upon their receipt of adequate annual appropriations from the U.S. Congress, and failure to receive adequate funds could prompt NASA to terminate its contracts with us or the prime contractor for convenience. There is no assurance that future funding will be adequate for NASA to complete all of its initiatives including those relating to contracts with us. We anticipate that a portion of our revenue for our next fiscal year will be derived from contracts with entities other than agencies of the U.S. Government that will not be subject to federal contract regulations such as termination for convenience or government funding restrictions.

Our Astrotech business unit serves the satellite launch industry which is dominated domestically by Lockheed Martin and Boeing. We have a contract in place with United Launch Alliance, successor to Lockheed Martin to support payload processing for the Atlas launch vehicle program and we also provide payload processing services for Boeing s Delta launch vehicle program. This contract guaranteed us a minimum of four launches annually through December 2006 and was extended through December 2007. In March 2007, United Launch Alliance extended the contract for one more year and has the option to extend it for an additional three years. We have other current contracts in place with NASA and Boeing for support of spacecraft processing activities in both Florida and California. Our Astrotech business unit manages the Sea Launch facility under a long-term contract with Sea Launch Company, LLC which expires in 2011.

Backlog Update

As of June 30, 2007 our contract backlog was approximately $26.8 million, of which $13.7 million represented U.S. Government backlog and $13.1 million, represented non-U.S. Government contracts. See Risk Factors Termination of our backlog orders could negatively impact our revenues for additional discussion of our backlog.

Research and Development

We incurred $0.8 million, $0.4 million, and $0.1 million in research and development expense during fiscal years 2007, 2006, and 2005, respectively. Research and development in fiscal year 2007 has been directed towards development of our mini-mass spectrometer product. Research and development in fiscal year 2006 and 2005 had been directed towards development of commercial responses to the National Vision for Space Exploration.

Certain Regulatory Matters

We are subject to federal, state, and local laws and regulations designed to protect the environment and to regulate the discharge of materials into the environment. We believe that our policies, practices, and procedures are properly designed to prevent unreasonable risk of environmental damage and consequential financial liability to us. Compliance with environmental laws and regulations and technology export requirements has not had in the past, and, we believe, will not have in the future, material effects on our capital expenditures, earnings, or competitive position. Our operations are subject to various regulations under federal laws relative to the international transfer of

technology as well as to various federal and state laws relative to business operations. In addition, we are subject to federal contracting procedures, audit, and oversight under Federal Acquisition Regulations.

Significant federal regulations impacting our operations include the following:

Federal Regulation of International Business. We are subject to various federal regulations relative to the export of certain goods, services, and technology. These regulations, which include the Export Administration Act of 1979 administered by the Commerce Department and the Arms Export Control Act administered by the State Department, impose substantial restrictions on the sharing or transfer of technology to foreign entities. Our activities in the development of space technology and in the processing of commercial satellites deal with technology of the type subject to these regulations. Our operations are conducted pursuant to a comprehensive export compliance policy that provides close review and documentation of activities subject to these laws and regulations.

Foreign Corrupt Practices Act. The Foreign Corrupt Practices Act establishes rules for U.S. companies doing business internationally. Compliance with these rules is achieved through established and enforced corporate policies and documented procedures in our internal procedures and financial controls.

Iran Nonproliferation Act of 2000. This act includes specific prohibitions on commercial activities with certain specified Russian entities engaged in providing goods or services to the International Space Station. Our activities with RSC Energia of Russia are not subject to this act.

Federal Acquisition Regulations. Goods and services provided by us to NASA and other U.S. Government agencies are subject to Federal Acquisition Regulations. These regulations provide rules and procedures for invoicing, documenting, and conducting business under contract with such entities. The Federal Acquisition Regulations also subject us to audit by federal auditors to confirm such compliance.

Truth in Negotiations Act. The Truth in Negotiations Act was enacted for the purpose of providing for full and fair disclosure by contractors in the conduct of negotiations with the U.S. Government. The most significant provision included in the Truth in Negotiations Act is the requirement that contractors submit certified cost and pricing data for negotiated procurements above a defined threshold.

Defense Security Service. From time to time we are requested to process government spacecraft payloads that must be handled under federal security clearances. To accommodate these requirements, we maintain facility security clearances within certain subsidiaries of the Company and have persons engaged by the Company with necessary active security clearances to support these requirements. Maintenance of an active facility clearance requires dedicated trained personnel, specified facility standards and recordkeeping.

Regulatory Compliance and Risk Management

We maintain compliance with regulatory requirements and manage our risks through a program of compliance, awareness, and insurance which includes the following:

Safety. We place a continual emphasis on safety throughout our organization. At the corporate level, safety programs and training are monitored by a corporate safety manager. A staff of senior safety professionals within our Flight Services business unit provides safety as a component of our space flight operations and augments the safety awareness and oversight available at the corporate level.

Export Control Compliance. We have a designated senior officer responsible for export control issues and the procedures detailed in our export control policy. This officer and the designated export compliance administrator monitor training and compliance with regulations relative to foreign business activities. Employees are provided comprehensive training in compliance with regulations relative to export and foreign activities through our interactive training program and are certified as proficient in such regulations as are relative to their job responsibilities.

Insurance. Our operations are subject to the hazards associated with operating assets in the severe environment of space. These hazards include the risk of loss or damage to the assets during storage, preparation for launch, in transit to the launch site, and during the space mission itself. We maintain insurance coverage against these hazards with reputable insurance underwriters. Although we did not fully insure our flight assets in the past, we now insure our flight assets at replacement value for risk of loss during future space flight missions.

Employees Update

As of June 30, 2007 we employed 176 regular full-time employees. The breakdown by area is as follows: SPACEHAB corporate and executive management is 24; 68 are employed by Flight Services; Government Services personnel total 46; and 33 are employed by Astrotech. Of these employees, approximately 15.2% hold advanced degrees beyond a bachelor s degree. Additionally, a significant number of our employees have experience in both the space industry and/or governmental space agencies, with a special expertise in commercial space and human space flight. None of our employees are covered by collective bargaining agreements.

Item 1A. Risk Factors.

The risks and uncertainties described below are not the only risks facing us. Additional risks not presently known to us or which we consider immaterial based on information currently available may also materially adversely affect us. If any of the following risks or uncertainties actually occurs, our business, financial condition, and results of operations could be materially adversely affected.

Risks Related to Our Business

After August 2007, our cash flows from operations associated with space shuttle missions will be materially reduced.

During fiscal year 2007, our Flight Services business unit derived over 98% of its revenues, which represented approximately 64% of consolidated revenues for fiscal year 2007, from the use of our modules and integrated cargo carriers by the space shuttle fleet. We have no contracted missions after August 2007 for our modules and we have terminated our leases for the integrated cargo carriers and will no longer have the use of the integrated cargo carrier. Our inability to generate new contracts on a timely basis will have a material adverse effect on our business, financial condition, and results of operations.

If we are unable to anticipate technological advances and customer requirements, including NASA s requirements for products and services, our business and financial condition will be adversely affected.

Our growth and future financial performance depend in part upon our ability to anticipate technological advances and customer requirements. There can be no assurance that we will be able to achieve the technological advances that may be necessary for us to remain competitive. In 2007, we commenced new business initiatives for the commercial exploitation of space. These new business initiatives will require large investments of capital and technical expertise. We may not be able to develop products and services in connection with these new business initiatives. Our failure to anticipate or respond adequately to changes in technology and NASA requirements, or delays in additional product development or introduction, could have a material adverse effect on our business and financial performance.

We plan to develop new products and services for the space industry. No assurances can be given that we will be able to successfully develop these products and services.

Our business strategy is to use the experience we have accumulated to expand the services and products we offer to the international space industry. These services and products generally involve the commercial exploitation of space, and involve new and untested technologies and business models. These technologies and business models may not be successful, which could result in the loss of any investment we make in developing them.

Our attempt to develop new technologies and business models to commercially exploit space will require substantial additional capital, which may not be available to us, and which, if available may substantially dilute equity owners.

Our future business operations will be focused on developing new technologies and business models for the commercial exploitation of space. We expect that these technologies and models will require substantial additional capital. No assurances can be given that capital will be available to us. The cost of future capital, if available, is likely to be very expensive, and is likely to substantially dilute holders of equity, including those that tender in the exchange offer.

We incur fixed lease obligations for our payload processing facilities used to support our module and space shuttle operations and have no contracts for such future business.

A substantial portion of our operating costs is a fixed lease obligation for our Cape Canaveral payload processing facility used to support our module and space shuttle operations. The balance of this lease extends over a period of

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We incur fixed lease obligations for our payload processing facilities used to support our module and space shuttle

four more years. We currently have no revenue-generating contracts for future business that would support our module and space shuttle operations. We must obtain new contracts in order to generate future revenue. Our inability to generate new contracts would have a material adverse effect on our business, financial condition, and results of operations. In addition, since a large portion of our operating costs are relatively fixed due to this lease obligation, variations in the timing and progress of future contracts can materially affect our business, financial condition, and results of operations.

The completion of our space shuttle module mission in August 2007 will result in the redeployment or reduction of technical and operations personnel, which may result in us incurring severance obligations.

Due to the completion of our space shuttle module mission in August 2007, we will either have to redeploy technical and operational personnel to other contracts, or reduce our workforce in order to lower our cost structure as part of a reorganization of operations. Any future reduction in workforce would be accompanied by the payment of severance obligations which could have a material adverse effect on our financial condition. In addition, a future reduction in workforce would be accompanied by a risk of litigation, which if initiated or successful, could harm our business and financial position.

Since we are dependent on NASA as a customer, if the products and services we are currently developing for use by NASA s successor to the Space Shuttle Program are not used, our financial condition and results of operations will be materially adversely affected.

Approximately 85% of our revenue for fiscal year 2007 was generated from eight contracts supporting NASA. We anticipate that revenue from NASA-related projects will continue to account for a material amount of our revenue in the future. In the past, we have developed products without any firm commitments from NASA. Although we may invest substantial amounts developing products for the shuttle s replacement program without any contracts with NASA, we cannot provide any assurances that such products will be used. Since the final program that will be chosen by NASA is not currently known, we cannot provide any assurances that the products and services we may develop will be suitable for such replacement programs. If NASA or its contractors do not purchase the products and services we are developing for the shuttle s replacement programs, our financial condition and results of operations will be adversely affected.

Termination of our backlog of orders could negatively impact our revenues.

As of June 30, 2007, we had a firm backlog of approximately $26.8. Firm backlog consists of aggregate contract values, excluding the portion previously recognized as revenues, in work change orders on existing contracts, and our estimate of potential award fees. Backlog as of June 30, 2007 does not give effect to new orders received or any terminations or cancellations since that date. Approximately 51% of our firm contract backlog as of June 30, 2007 was derived from contracts with the U.S. Government and its agencies or from subcontracts with the U.S. Government s prime contractors. Since our government contracts are contingent upon Congressional appropriations and are terminable for convenience, we cannot assure that our backlog will ultimately result in revenues.

Our existing NASA contracts are subject to continued appropriations by Congress and may be terminated if future funding is not made available, which would have a material adverse effect on our business.

Our financial performance is substantially dependent on the revenue generated from our contracts supporting NASA which, similar to contracts with other agencies of the U.S. Government, are conditioned upon the continuing availability of Congressional appropriations. The U.S. Congress usually appropriates funds for a given program on a fiscal year basis even though contract performance may extend over many years. Failure to receive sufficient funds from Congress or a withdrawal by Congress of prior appropriations would permit NASA to terminate its contracts with us for convenience. Therefore, no assurances can be made that Congress will continue to fund NASA at levels which will permit space shuttle missions to continue on their current schedules or that Congress will appropriate the funds necessary for NASA to fulfill its obligations under its contracts with us. Any substantial reduction in Congressional funding for space shuttle missions or annual appropriations to NASA to fulfill, among other things, NASA s contracts with us or the U.S. commitment to the International Space Station, would have a material adverse effect on our financial condition and results of operations. In addition, termination of large programs or multiple contracts affecting our Flight Services business unit could require us to evaluate the continued viability of operating that business.

Our existing NASA contracts are subject to continued appropriations by Congress and may be terminated if future f 45

As a U.S. Government contractor, we are subject to a number of rules and regulations, the violation of which could result in us being barred from future U.S. Government contracts.

As a U.S. Government contractor, we are subject to a number of rules and regulations, the violation of which could

We must comply with and are affected by laws and regulations relating to the award, administration, and performance of U.S. Government contracts. These laws and regulations, among other things:

- Require certification and disclosure of all cost or pricing data in connection with certain contract negotiations.

- Impose acquisition regulations that define allowable and unallowable costs and otherwise govern our right to reimbursement under certain cost-based U.S. Government contracts.

- Restrict the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

A violation of specific laws and regulations could result in the imposition of fines and penalties, the termination of our contracts, or debarment from bidding on U.S. Government contracts. In some instances, these laws and regulations impose terms or rights that are more favorable to the Government than those typically available to commercial parties in negotiated transactions. For example, the Government may terminate any of our government contracts for convenience, as well as for default based on performance. In addition, U.S. Government contracts generally contain provisions that allow the Government to unilaterally suspend us from receiving new contracts pending resolution of alleged violations of certain federal laws or regulations, reduce the value of existing contracts, issue modifications to a contract, and control and potentially prohibit the export of our services and associated materials. Since a majority of our revenues are currently, and a material portion of future revenues are expected to be, derived from contracts supporting NASA, material modifications to our existing contracts or a prohibition against bidding on future U.S. Government contracts would have a material adverse affect on our financial condition and results of operations.

Our business could be adversely affected by a negative audit by the U.S. Government.

U.S. Government agencies, including NASA, routinely audit and investigate government contractors. These agencies review a contractor s performance under its contracts, cost structure, and compliance with applicable laws, regulations, and standards. The U.S. Government also may review the adequacy of, and a contractor s compliance with, its internal control systems and policies, including the contractor s purchasing, property, estimating, compensation, and management information systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed, while such costs already reimbursed must be refunded. If an audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or prohibition from doing business with the U.S. Government. In addition, we could suffer serious reputational harm that affects our non-governmental business if allegations of impropriety were made against us.

Most of our competitors have much greater financial resources than we do.

The U.S. Government, the governments of other countries and private companies participate in the highly competitive space industry often as both suppliers and end-users of space services. Our long-term strategy growth is to commercially exploit space. These strategies could require us to compete with commercial companies such as The Boeing Company, Lockheed Martin Corporation and other large aerospace companies, many of which have existing NASA support contracts, substantially greater financial resources and manufacturing capabilities, more established and larger marketing and sales organizations, and larger technical staffs than we have.

United Space Alliance, which is equally owned by The Boeing Company and Lockheed Martin Corporation, is the primary contractor for NASA s Space Shuttle Program. United Space Alliance is responsible for the day-to-day operation and management of the U.S. Space Shuttle fleet. United Space Alliance is currently the primary contractor in the market for civil ground operations and payload processing services. We believe that the privatization of space station operations and successor programs will continue to result in intense competitive pressure among contractors to retain their current contracts and/or capture new payload processing work from other contractors. To the extent that these contractors are able to retain or enlarge their roles in payload processing operations, our ability to successfully compete for a share in this market could be impeded, which could have a material adverse effect on our future financial performance.

At present, competition in the United States for our Astrotech spacecraft launch processing services is limited to the California (Vandenberg) launch site, where a competing company called California Commercial Spaceport Systems International is located. California Commercial Spaceport Systems International does not have payload processing

facilities in Florida, which is where the majority of U.S. commercial satellite launches occur. However, if California Commercial Spaceport Systems International or another satellite launch processing service provider were to build in Florida, or NASA were to expand its facilities in Florida, our financial performance could be adversely affected.

The Astrotech strategy of extending the life of satellites has been in development for years by Boeing, DARPA, U.S. Naval Research Labs the U.S. Air Force and various European companies. Advancement by these entities or their ability to secure early contracts in this new sector could adversely affect our future growth plans and financial performance.

A branch of the U.S. Government could construct spacecraft ground processing facilities at one or more of the domestic launch sites served by Astrotech which could significantly reduce the number of missions using Astrotech s facilities.

Astrotech currently provides services for domestic launch sites. In the event that the U.S. Government constructs spacecraft ground processing facilities that would compete with the launch sites currently serviced by Astrotech, there would be a reduced need for use of Astrotech s facilities. This would result in the U.S. Government competing directly with us for our existing customers in connection to servicing domestic launch sites, which in the aggregate could significantly reduce our revenues. The U.S. Government, as a competitor to Astrotech, may have more extensive or more specialized engineering, manufacturing and marketing capabilities than we do in this area of spacecraft ground processing facilities. There can be no assurance that we will be able to compete successfully against the U.S. Government as a potential competitor in this area or that these competitive pressures we may face will not result in reduced revenues and market share for us.

Our earnings and margins may vary because many of our contracts are fixed-price contracts.

As of June 30, 2007, we had one significant cost-reimbursable and 11 significant fixed-price contracts. Cost-reimbursable contracts generally have lower profit margins than fixed-price contracts. Our Flight Services and Astrotech spacecraft processing business units contracts are mainly fixed-price contracts.

Under fixed-price contracts, we receive a fixed price irrespective of the actual costs we incur and, consequently, any costs in excess of the fixed price are absorbed by us. Cost overruns also may adversely affect our ability to sustain existing programs and obtain future contract awards. Under a fixed-price contract, if we are unable to control costs we incur in performing under the contract, our financial condition and operating results could be materially adversely affected.

We are under a fixed-price contract to construct building improvements for a government client at Astrotech s facilities and could incur losses or performance penalties in completing the work.

We currently have a contract to construct building improvements for the U.S. Government at Astrotech s facilities on a fixed-price basis. While a fixed-price contract allows us to benefit from cost savings, it also exposes us to the risk of cost overruns. If the initial estimates we used to calculate the contract price and the cost to perform the work prove to be incorrect, we could incur losses. In addition, this contract has specific provisions relating to cost, schedule, and performance. If we fail to meet the terms specified in such contract, then our cost to perform the work could increase or our price could be reduced, which would adversely affect our financial condition. Moreover, successful performance of this contract depends on our ability to meet production specifications and delivery rates. If we are unable to perform and deliver under contract requirements, our contract price could be reduced through the incorporation of performance penalties, such as liquidated damages, termination of the contract for default, or other financially significant exposure. Thus, this fixed-price contract has a substantial risk for potential losses if our estimated costs exceed our estimated price or if we cannot perform in accordance with the terms of the contract.

Most of the costs for our Astrotech business unit are fixed regardless of the number of spacecraft that are processed at our facility.

The primary costs related to our Astrotech business unit are associated with operating and running our three spacecraft launch processing facilities. These costs remain relatively unchanged regardless of whether or not customers are using the facilities. As a result, if we do not properly estimate the number of satellites that will be processed when calculating our price structure for our spacecraft processing services, our financial results could be adversely affected.

Most of the costs for our Astrotech business unit are fixed regardless of the number of spacecraft that are processe

Our financial results could be adversely affected if the estimates that we use in accounting for contracts are incorrect and need to be changed.

Contract accounting requires judgment relative to assessing risks, estimating contract revenues and costs, and making assumptions for schedule and technical issues. The estimation of total revenues and cost at completion for many of our contracts is complicated and subject to many variables. Assumptions have to be made regarding the length of time to complete the contract because costs also include expected increases in wages and prices for materials. Incentives or penalties related to performance on contracts are considered in estimating revenue and profit rates, and are recorded when there is sufficient information for us to assess anticipated performance. Estimates of award and incentive fees are also used in billing customers and estimating revenue and profit rates based on actual and anticipated awards. If our performance under a cost reimbursable contract results in an award fee that is lower than we have estimated, we would be required to refund previously billed fee amounts and would have to adjust our revenue recognition accordingly. If our performance was determined to be significantly deficient, we may be required to reimburse our customer for the entire amount of previously billed awards.

Because of the significance of the judgments and estimation processes described above, it is likely that materially different amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. Changes in underlying assumptions, circumstances, or estimates may adversely affect future period financial performance.

If we are unable to find users of future products we develop without a contract for such product, we will have to write-off the value of such assets.

We have in the past, and expect to continue in the future, to fund development of certain projects prior to being awarded a contract for such projects. No assurances can be made that any funds we may spend in the future in connection with the development of new products will lead to the award of a contract or that any such contract will be awarded on terms that are economically favorable to us. In addition, we depreciate space hardware, and intend to depreciate future capital assets that are dedicated to supporting the space shuttle over a period that approximates the useful life of the space shuttles. However, since we do not expect to receive additional contracts for the use of our modules, we will be required to write-off the remaining value of our modules. In addition, in the event we are not awarded contracts for the use of future products or services, we could be required to write-off the value of any future capital assets, and/or costs of prepaid services performed, which could have a material adverse effect on our financial condition and results of operations.

Our spacecraft payload processing facilities are specifically designed to process satellites and other payloads and we would lose a substantial portion of their value if we no longer provided these services.

Our Astrotech spacecraft processing facilities and the payload processing facilities for our Flight Services business unit were built specifically to process satellites and our modules and integrated cargo carriers. These facilities are not well suited for other uses. Currently, our Astrotech facilities in Titusville, Florida are depreciated using the straight-line method over their estimated useful lives which range from 16 to 40 years. If we were required to terminate our satellite or module processing businesses, the value of these facilities would be significantly impaired. In addition to having to take a substantial write-down of the value of our Titusville, Florida facility on our books, if we attempted to sell this facility we do not think that we would be able to recover the amounts we have invested. If we were able to sublease our leased facilities, we do not think such subleases would be sufficient to cover our current rental payments. Due to our substantial capital expenditures for our spacecraft processing facilities and the limited uses of these facilities, the termination of operations at our Titusville, Florida facility that we own, or one or more of our other leased facilities could have a material adverse effect on our financial condition and results of operations.

We incur substantial costs in preparing proposals to bid on contracts that we may not be awarded.

Preparing a proposal to bid on a contract is generally a three to six month process. This process is time consuming and results in the incurrence of substantial costs that are generally not reimbursable even if the contract is awarded. We have prepared proposals for and bid on contracts that were not awarded to us in the past and anticipate that we could incur substantial costs related to contracts that are not ultimately awarded to us in the future. In addition, even if we are awarded a contract, we generally do not begin performing work for several months after the bidding process is complete. If funding problems by the party awarding the contract or other matters further delay our commencement of work on the contract, these delays may lower the value of the contract to us, even rendering it unprofitable.

Because our operating results are highly dependent on the timing of space shuttle missions and spacecraft launches, they may fluctuate significantly from quarter to quarter.

Our microgravity product processing strategy relies on sending our payload samples to and from space which requires us to rely on access to space on-board the space shuttle, Progress, Soyuz, ATV, Falcon, HTV, ARCTUS or K-1 rockets. The timing and availability of space shuttles or spacecraft missions that could carry our samples, the availability of third party launch vehicles, the number and types of missions flown, the number and timing of satellite launches that use our Astrotech spacecraft processing facilities, and other factors can cause our results of operations to fluctuate significantly from quarter to quarter.

Most obligations under our contracts, including contract-related engineering, research and development, and selling, general and administrative expenses, are recorded in the periods in which they are incurred. Accordingly, we may report routine operating losses in quarters in which no space missions are in process.

In addition, we have incurred significant losses in the past and, as such, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

Compliance with environmental and other government regulations could be costly and could negatively affect our financial condition.

Our business, particularly our Astrotech spacecraft processing business unit, is subject to numerous laws and regulations governing the operation and maintenance of our facilities and the release or discharge of hazardous or toxic substances, including spacecraft fuels and oxidizers, into the environment or otherwise relating to environmental protection. Under these laws and regulations, we could be liable for personal injury and clean-up costs and other environmental and property damages, as well as administrative, civil, and criminal penalties in the event of a violation of these laws, or a release of a hazardous substances at or from our facilities, and such liabilities could have a material adverse effect on our business, financial condition, and results of operations.

Our failure to comply with U.S. export control laws and regulations could adversely affect our business.

We are obligated by law and under our NASA contracts to comply, and to ensure that our subcontractors comply, with all U.S. export control laws and regulations, including the International Traffic in Arms Regulations and the Export Administration Regulations. We are responsible for obtaining all necessary licenses or other approvals, if required, for exports of hardware, technical data, and software, or for the provision of technical assistance. We are also required to obtain export licenses, if required, before utilizing foreign persons in the performance of our NASA contracts if the foreign person will have access to export-controlled technical data or software. The violation of any of the applicable export control laws and regulations, whether by us or any of our subcontractors, could subject us to administrative, civil, and criminal penalties.

Our inability to maintain required government security clearances or the impact of foreign ownership or control could result in a loss of potential future spacecraft ground processing and other opportunities.

In order to be a service and product provider for spacecraft ground processing and other related activities, we are required to maintain certain government security clearances and we must comply with laws that limit foreign ownership and control. We may be subject to regulatory action and possibly other sanctions if we fail to comply with applicable laws and regulations relating to required security clearances and foreign ownership and control. This could harm our reputation, our prospects for future work and our operating results. Failure to comply could also result in the termination of current operations. A finding by the U.S. Government that we are not in compliance with security clearance standards could materially and adversely affect us. Similarly, a finding by the U.S. Government that we are not in compliance with foreign ownership and control laws or other related legislative requirements could materially and adversely affect us.

Our facilities located in Florida and California are particularly susceptible to damage caused by hurricanes, earthquakes, or other natural disasters.

Our largest Astrotech spacecraft processing facility, which we own, and our leased Flight Services facility on the east coast of Florida are particularly susceptible to damage caused by hurricanes or other natural disasters. In addition, our leased launch processing facilities at Vandenberg Air Force Base and the facilities we operate at the Port of Long Beach are subject to damage caused by earthquakes. The extent to which the buildings located at these facilities are designed to sustain natural disasters varies. Although we insure our properties and maintain business

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Our facilities located in Florida and California are particularly susceptible to damage caused by hurricanes, earthqua

interruption insurance, there can be no assurance that such insurance would be sufficient. If a severe hurricane, earthquake, or other natural disaster materially affected any of these facilities, our financial condition and results of operations could be adversely affected.

The loss of key management and other employees could have a material adverse effect on our business.

We are dependent on the personal efforts and abilities of our senior management, and our success will also depend on our ability to attract and retain additional qualified employees. We do not maintain key man insurance with any of these employees. Failure to attract personnel sufficiently qualified to execute our strategy, or to retain existing key personnel, could have a material adverse effect on our business.

A long and protracted restructuring could cause us to lose key management and technical employees and otherwise adversely affect our business.

If we fail to consummate the exchange offer on a timely basis, any alternative we pursue, whether in or out of court, may take substantially longer to consummate than the exchange offer. A protracted financial restructuring would further disrupt our business and would divert the attention of our management from operation of our business and implementation of our business plan. It is likely that such a prolonged financial restructuring or bankruptcy proceeding would cause us to lose many of our key management employees, including the most senior members of management. It is also likely a prolonged financial restructuring or bankruptcy proceeding would cause us to lose customer contracts or be ineligible to obtain government contracts. Such losses or key management employees would likely make it difficult for us to complete a financial restructuring and may make it less likely that we will be able to continue as a viable business (see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources).

There may be no market for our stock on an active trading market.

The NASDAQ has notified us that we are in violation of their listing requirements, since we have not maintained our share price for our common stock of $1.00 or more. If we do not meet the share price requirement by October 3, 2007, our common stock may be delisted from NASDAQ. If we are delisted we have no current plans to list on any securities exchange or other stock market. It is possible that the market for our stock will be subject to disruptions. You may not be able to sell your stock when you want and, if you do sell, you may not be able to receive the price you want.

If we fail to comply with Section 404 of the Sarbanes-Oxley Act of 2002, our reputation, financial condition, and the value of our notes and capital stock may be adversely affected.

Beginning with our report for the fiscal year ending June 30, 2008, Section 404 of the Sarbanes-Oxley Act of 2002 will require us to include an internal control report of management with our annual report on Form 10-K, which is to include management s assessment of the effectiveness of our internal control over financial reporting as of the end of the fiscal year. The report will also be required to include a statement that our independent auditors have issued an attestation report on management s assessment of our internal control over financial reporting.

In order to achieve compliance with Section 404 within the prescribed period, management is utilizing outside consultants to aid us in the adoption of a detailed project work plan that assesses the adequacy of our internal control over financial reporting, remediates any control weaknesses that may be identified, validates through testing that controls are functioning as documented, and implements a continuous reporting and improvement process for internal control over financial reporting. However, we may not be able to complete the work necessary for our management to issue its management report in a timely manner, or any work that will be required for our management to be able to report that our internal control over financial reporting is effective. In addition, our independent auditors may not be able to issue an attestation report on management s assessment. Our failure to comply with Section 404, including issuing the management report and obtaining the attestation report, may materially adversely affect our reputation, our financial condition, and the value of our securities, including our outstanding notes, exchange units, and common stock. Furthermore, our costs of compliance with Section 404, including the cost of remedying any identified weaknesses, could be material and could adversely affect our financial condition and results of operations.

If we fail to comply with Section 404 of the Sarbanes-Oxley Act of 2002, our reputation, financial condition, and the

If we are unable to effect the exchange offer, we may file for bankruptcy, which could have a material adverse effect on our business.

If we are unable to complete the exchange offer for any reason, we may restructure through a bankruptcy proceeding. Our ability to restructure in bankruptcy is subject to numerous risks, including the following:

- We may lose customers in bankruptcy because our services are critical to our customers businesses.
- The costs of bankruptcy will significantly exceed the costs of an out-of-court transaction.
- We may be unable to arrange debtor-in-possession financing or otherwise finance our operations during bankruptcy.

Any alternative restructuring through a bankruptcy proceeding could be on terms less favorable than those set forth in this exchange offer. If a bankruptcy proceeding were to occur, there is a risk that your ability to recover your investments would be substantially delayed and more impaired than under the proposed exchange offer. The expenses of any bankruptcy case could reduce the assets available for payment or distribution to our creditors, including holders of the Junior Notes and Senior Notes. In addition, a bankruptcy proceeding (either voluntary or involuntary) may not increase the amount of any payment or distribution that you, as a tendering holder, would receive. In fact, a bankruptcy proceeding could reduce such amount and, in any event, would delay any payment or distribution.

Even if the exchange offer is successfully consummated, we will still need substantial additional capital.

Our capital requirements for continuing operations consist of our general working capital needs, scheduled principal and interest payments on our debt obligations, certain contractual commitments, and capital expenditures. This includes short-term capital to finance continuing operations at the end of 2007, and long-term capital to finance our growth. Our capital resources which are solely comprised of cash reserves and cash generated from operations, may not be sufficient to meet these capital requirements. While we believe that the exchange offer would help address our foreseeable refinancing risk related to the Junior Notes that mature in October 2007, there is no assurance that the exchange offer will be sufficient to alleviate our liquidity issues due to a lack of capital resources. In addition, with the conclusion of STS-118 in August 2007, we expect to have a material decrease in our revenue from our Flight Services business, which has accounted for over 70% of our consolidated revenue during the first nine months of fiscal year 2007. Moreover, our revolving credit line expired on February 11, 2007. As a result, in order to continue to fund our current operations, we will need additional capital. No assurance can be given that we will be able to obtain a new source of capital on terms that are acceptable to us. If we are unable to obtain new capital, we may be forced to subject ourselves to bankruptcy, reorganization, liquidation, dissolution or similar proceeding.

Restructuring our obligations under our outstanding notes has resulted in increased costs to us.

We are incurring significant restructuring costs in connection with the exchange offer. The exchange offer has also resulted in significant costs to us as we pay professional fees related to evaluating our restructuring alternatives and pursuing the exchange offer. These increased costs may have a material adverse effect on our financial condition.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

Our three business units, Flight Services, Astrotech, and Government Services, currently occupy four locations. The corporate headquarters which had been located at 300 D Street SW, Suite 814, Washington, D.C. 20024 was re-designated to 12130 Highway 3, Webster, Texas 77598 in fiscal year 2002. The term of the present lease for the D Street space expires on December 16, 2007. As of June 30, 2002 we sublet the entire D Street space through the end of the term of our lease. Our other Washington, D.C. office location was closed as of December 31, 2003 and all executive and administrative functions were consolidated at our Webster, Texas office.

Our executive management, marketing and communications, human resources, finance, and operations support personnel, along with one Government Services employee and approximately two-thirds of the Flight Services employees are located at 12130 Highway 3, Building 1, Webster, Texas 77598. The facility consists of 90,867 square feet of office, warehouse, and fabrication space located near the Johnson Space Center. On May 26, 2005 we purchased this facility, including the building and the adjacent three acres of land for the value of $2.0 million. We then sold the building, excluding the three acres of adjacent undeveloped land, for $3.25 million. We are leasing

back 100% of the facility for an initial period of ten years, with two five-year options. We will retain the adjacent 3.0 acres parcel for future development or sale.

Our Flight Services payload processing facility, housing a 19-person operations team, is located near the Kennedy Space Center in Cape Canaveral, Florida. The facility is contained in an approximately 58,000 square foot plant. The payload processing facility has a clean room work area of approximately 24,000 square feet. This work area is designed to accommodate our single and double modules, as well as the Integrated Cargo Carriers (ICCs) and vertical cargo carrier. This area includes eleven secure experiment/payload integration and work areas ranging in size from 300 square feet to 1,000 square feet each. In addition, the facility provides office space, stock rooms, storage areas, a machine shop, an electrical shop, conference rooms, and other miscellaneous accommodations. We negotiated an agreement with the Canaveral Port Authority for the lease of the land for a forty-three year period which commenced on August 28, 1997. Upon expiration of the land lease, all improvements on the property revert at no cost to the lessor. On May 2, 2005 we sold the 58,000 square-foot processing facility in Cape Canaveral, Florida for $4.8 million. We now lease back 100% of the facility for an initial period of five years, with an option period of an additional five years.

Astrotech occupies two company-owned locations. Astrotech s headquarters and Florida operations team, consisting of 22 personnel, are located in a nine-building complex located on a 62-acre space technology campus at 1515 Chaffee Drive, Titusville, Florida 32780. This campus encompasses 140,000 square feet of facility space supporting non-hazardous and hazardous flight hardware processing, payload storage, and customer offices. The construction of an additional 50,000 square foot spacecraft processing facility was completed in March 2002. These buildings presently occupy one-third of the 62-acre property owned by Astrotech, with one-third available for expansion and the remaining one-third reserved for hazardous facility safety clearances.

Astrotech has a four-person technical staff located on Vandenberg Air Force Base in Santa Barbara County, California. Astrotech presently leases a 60-acre site on the base and owns four buildings comprising 18,800 square feet, dedicated to the same functions provided at the Florida facility. The term of the present land lease expires on July 13, 2013, with provisions to extend the lease at the request of the lessee and the concurrence of the lessor. Upon final expiration of the land lease, all improvements on the property revert, at the lessor s option, to the lessor at no cost. During fiscal year 2007, we began an expansion of this facility that will be completed during 2009 that will enhance our capabilities to process five meter satellite payloads.

Additionally, Astrotech has seven employees who are housed at the Sea Launch Home Port facility in Long Beach, California provided in accordance with the provisions of the Astrotech contract with Sea Launch Company, LLC.

Government Services has 45 employees who are housed in two government facilities within the Houston area.

We believe that our current facilities and equipment are generally well maintained and in good condition, and are adequate for our present and foreseeable needs.

Item 3. Legal Proceedings.

In January 2004 the Company initiated a formal proceeding against NASA in which the Company was seeking damages in the amount of $87.7 million for the loss of its Research Double Module (RDM) as a result of the Columbia accident. In October 2004, NASA responded to this claim with the determination that its liability was $8.2 million, including interest, and paid SPACEHAB this amount. SPACEHAB subsequently filed an appeal with the Armed Services Board of Contract Appeals and over the past two years, the two parties have proceeded with preparations for a court hearing planned for July 2008. The Company also filed a tort claim in November 2004, seeking damages of $79.7 million for the loss of the RDM, to which the court granted a motion in June 2006 to stay the case until resolution of the Company s contract claim appeal.

In October 2004 we received payment from NASA in the amount of $8.2 million which included $0.2 million of interest. NASA s claims were that their liability was limited to $8.0 million under the Research and Logistics Mission Support contract (NAS9-97199), as specifically identified in clause H.11 titled Contingent Property Liability.

This $8.2 million indemnification payment and interest payment was accordingly recorded as a Recovery of nonrecurring charge in the September 30, 2004 financials, resulting in a change in cash flows from operating activities.

On February 21, 2007, the Company dismissed with prejudice all litigation against NASA relating to losses incurred by the Company as a result of the February 2003 Space Shuttle Columbia accident.

As a result of the claim dismissal, the Company paid Lloyd s of London, the insurer of the RDM, $0.5 million in accordance with the May 12, 2005 agreement with Lloyd s.

Except as above, the Company is not a party to any pending or threatened proceedings, which in management s opinion, would have a material adverse effect on our business, financial condition, or results of operation.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of stockholders during the fourth quarter of the year ended June 30, 2007.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our Common Stock previously traded on the NASDAQ National Market System under the symbol SPAB up until March 21, 2006 at which point our common stock commenced trading on the NASDAQ Capital Market. The following table sets forth the quarterly high and low intra-day bid prices for the periods indicated.

Fiscal 2007	High	Low
First Quarter	$ 1.35	$ 0.67
Second Quarter	$ 0.78	$ 0.60
Third Quarter	$ 1.23	$ 0.57
Fourth Quarter	$ 0.71	$ 0.46

Fiscal 2006	High	Low
First Quarter	$ 2.04	$ 1.07
Second Quarter	$ 1.25	$ 0.68
Third Quarter	$ 1.15	$ 0.68
Fourth Quarter	$ 1.41	$ 0.85

We have never paid cash dividends. It is our present policy to retain earnings to finance the growth and development of our business and, therefore, we do not anticipate paying cash dividends on our Common Stock in the foreseeable future.

We have 70,000,000 shares of Common Stock authorized for issuance. As of September 19, 2007 we had 13,027,196 shares of Common Stock outstanding. We had approximately 221 shareholders of record of our Common Stock on September 19, 2007.

The NASDAQ has notified us that we are in violation of their listing requirements, since we have not maintained a share price of our Common Stock of $1.00 or more. If we do not meet the share price requirement by October 3, 2007, our Common Stock may be delisted from the NASDAQ.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights (a)	Weighted average exercise price of outstanding options, warrants, and rights (b)	Number of securitie remaining available for future issuance (c)
Equity compensation plans approved by security holders	1,076,935	$ 2.606	3,185,774
Equity compensation plans not approved by security holders			
Total	1,076,935	$ 2.606	3,185,774

SPACEHAB Stock Performance Graph

The following performance graph and table do not constitute soliciting material and the performance graph and table should not be deemed filed or incorporated by reference into any other previous or future filings by us under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate the performance graph and table by reference therein.

The performance graph and table below compare the five-year cumulative total return of our common stock with the comparable five-year cumulative total returns of the Standard & Poor s Aerospace & Defense Stock Index (S&P Aerospace & Defense) and the NASDAQ Composite Stock Index (NASDAQ Composite). The figures assume an initial investment of $100 at the close of business on June 30, 2002 in SPACEHAB, S&P, and NASDAQ, and the reinvestment of all dividends.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among SPACEHAB, Incorporated, The NASDAQ Composite Index

And The S&P Aerospace & Defense Index

SPACEHAB FISCAL YEAR END	6/02	6/03	6/04	6/05	6/06	6/07
SPACEHAB, Incorporated	100.00	74.80	289.76	140.94	92.91	51.18
NASDAQ Composite	100.00	109.91	139.04	141.74	155.82	191.32
S&P Aerospace & Defense	100.00	80.03	105.93	123.79	147.46	183.11

Issuer Purchases of Equity Securities

On March 25, 2003 our Board of Directors authorized us to repurchase up to $1.0 million of our outstanding stock at market prices. As of June 30, 2007 we had repurchased 116,100 shares at a cost of $117,320.

On July 13, 2005 we entered into an amendment to the Amended and Restated Rights Agreement, dated as of February 23, 2004, between us and American Stock Transfer & Trust Company, as rights agents, which had the effect of terminating our Rights Agreement effective July 13, 2005.

Sales of Unregistered Securities

During fiscal year 2007 we did not issue any unregistered securities.

Item 6. Selected Financial Data.

The following table sets forth our selected consolidated financial data as of and for the years ended June 30, 2003, 2004, 2005, 2006, and 2007. Such data has been derived from our consolidated financial statements audited by Ernst & Young LLP for the fiscal year ended June 30, 2003, by Grant Thornton LLP for the fiscal years ended June 30, 2004, 2005, and 2006, and by PMB Helin Donovan, LLP for fiscal year ended June 30, 2007. The data set forth below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors and our Consolidated Financial Statements and Notes thereto included in this annual report. All amounts, except per share amounts, are in thousands.

	Years Ended June 30, 2003	2004	2005	2006	2007
Statement of Operations Data:					
Revenue from operations	$ 94,963	$ 77,606 (3)	$ 59,401	$ 50,746	$ 52,762
Costs of revenue	78,791	45,678	47,158	46,855 (7)	51,029 (9)
Gross profit	16,172	31,928	12,243	3,891	1,733
Selling, general and administrative expenses	91,434 (1)	20,982 (4)	1,639 (5)	10,672	13,762 (9)
Research and development expenses	118	223	77	410	801
Income (loss) from operations	(75,380)	10,723	10,527	(7,191)	(12,830)
Interest expense, net of capitalized amounts and interest and other income	7,252	8,142	5,424	5,174 (8)	3,531
Net income (loss)	(81,775)	2,075	5,249	(12,397)	(16,292)
Net income (loss) per common share basic	$ (6.66)	$ 0.17	$ 0.42	$ (0.97)	$ (1.26)
Net income (loss) per common share diluted	$ (6.66)	$ 0.15	$ 0.37	$ (0.97)	$ (1.26)
Shares used in computing net income (loss) per common share basic	12,285	12,450	12,613	12,744	12,920
Shares used in computing net income (loss) per common share diluted	12,285	14,142	14,190	12,744	12,920
Cash dividends declared per common share					
Other Data:					
Cash provided by (used in) operations	$ 2,114	$ 5,273	$ (7,153)	$ 3,984 (8)	$ 12,310 (10)
Cash provided by (used in) investing activities	3,037 (2)	5,019	17,683 (6)	(1,141)	(7,359) (11)
Balance Sheet Data (at period end):					
Working capital (deficit) surplus	$ (4,750)	$ (6,351)	$ 5,435	$ 2,753	$ (5,545)
Total assets	121,356	99,925	101,951	85,450	72,475
Long-term debt, excluding current portion	80,056	66,942	64,885	63,250	52,944
Stockholders equity (deficit)	5,090	9,410	14,797	2,809	(13,131)

(1) Includes approximately $78.3 million of non-cash write downs related to the loss of our research double module, goodwill impairment at our Government Services business unit, and asset impairment.
(2) Includes approximately $17.7 million of insurance proceeds related to the loss of our research double module.
(3) Includes approximately $17.5 million due to Boeing s termination of its spacecraft processing contract with us.
(4) Includes approximately $0.3 million of non-cash expenses related to subleasing of excess facilities, $8.3 million of goodwill impairment at our Government Services and Astrotech Space Operations business units, and a $1.8 million non-cash write-down of an investment in Guignè.
(5) Includes $7.7 million of net recovery from non-recurring transactions related to the loss of our research double module.
(6) Includes approximately $8.2 million from ReALMS contract indemnification clause related to the loss of our research double module.
(7) Includes approximately $6.3 million of non-cash write downs related to our flight unit 3 and the shuttle based flight assets.
(8) Includes approximately $0.6 million of non-cash charges related to the acceleration of debt placement fees related to the convertible subordinated notes.
(9) Includes approximately $12.5 million of non-cash write downs related to our flight unit 2 and the shuttle based flight assets and a $0.1 million non-cash write down of an investment in Applied Astronautical Corporation.
(10) Includes $5.7 million advance for construction of a payload processing facility. Also includes $3.1 million advance from customer for in-flight insurance for STS-118 that was paid in July 2007 to the insurance carrier.
(11) Includes approximately $6.3 million of restricted cash for the construction of a payload processing facility.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with, and is qualified in its entirety by reference to, our audited consolidated financial statements and notes thereto included elsewhere in this report.

Historically, we have operated in three main areas generally related to space flight activities within the aerospace industry: space assets and mission support services for manned and unmanned space exploration and research missions; commercial and exploratory satellite pre-launch services; and engineering services in support of government and commercial space operations. Because of the diversity among the operations of our activities, we report the results of each business as a separate segment in our consolidated financial statements. Our consolidated financial results also reflect corporate-level expenses such as general and administrative, interest, and depreciation and amortization, but because of their nature, these items are not reported as a separate segment.

Overview

We provide a range of products and services that focus on the needs of industry, governments and academia requiring access to, and utilization of the unique environment of space. We employ a staff of engineers and technicians who have supported approximately 250 manned and unmanned missions to space from multiple locations worldwide, including 23 space shuttle missions. We offer products and services in the following areas:

- Expertise in qualifying hardware for spaceflight and the habitability and occupational challenges of space;
- Facilities and support services necessary for the preparation of satellites and payloads for launch;
- Engineering, analysis, and payload operations services;
- Program integration and control; and
- Product design, development, and fabrication.

Our Business Units

Our company is currently comprised of three primary business segments which provide the following products and services to the government and commercial markets. Our business units include:

SPACEHAB Flight Services. The primary goal of our Flight Services business unit is to enable government and commercial enterprises to overcome the accessibility, habitability and occupational challenges of space. To meet our clients specific mission requirements, we offer a range of engineering, research, logistics, integration, operations, and ground support services. Through this business unit, we have and will continue to offer a full range of ground-based pre- and post-flight experiment, cargo, and payload processing services as well as on-orbit operations support. Additionally, we are supporting contracts for ongoing flight hardware manufacturing projects in support of NASA and international customers. Our Flight Services Business Unit generates revenue by providing turnkey services generally on a fixed price basis. We recognize revenue for mission contracts that extend over multiple financial reporting periods using the percentage of completion method which relies upon estimates of costs and time to complete, as well as other estimates. During fiscal year 2007, our Flight Services business unit accounted for 65% of our consolidated revenues.

The primary factors impacting our Flight Services business unit earnings and cash flows are the number of space shuttle missions flown, the requirements for use of our space shuttle hardware and the configuration of the cargo handling and research logistics required for each mission. Other factors that have impacted, and are expected to continue to impact earnings and cash flows for this business unit include:

- NASA s use of our space shuttle modules and related space assets that utilize our competencies in configuration and cargo handling.
- Commercial demand for access to space launch capability and need for research cargo logistics

- Space shuttle mission requirements for the manufacture of specialized cargo handling equipment.

Astrotech Space Operations. Our Astrotech business unit provides modern facilities and support for the preparation of multi-million dollar satellites and payloads for launch on expendable launch vehicles. Since 1985, our Astrotech business unit has been providing government and commercial customers with a commercial alternative to using government-owned facilities to prepare their satellites for launch in the United States. Astrotech currently has long-term contracts in place with NASA, United Launch Alliance, National Reconnaissance Office and Sea Launch, LLC. During fiscal year 2007, Astrotech accounted for 23% of our consolidated revenues.

Revenue for our Astrotech business unit is generated from various fixed-priced contracts with launch service providers in both the commercial and government markets. The services and facilities we provide to our customers support the final assembly, checkout, and countdown functions associated with preparing a spacecraft for launch. The earnings and cash flows generated from our Astrotech operations are related to the number of commercial spacecraft launches, which reflects the growth in the satellite-based communications industries, and the requirement to replace aging satellites. Other factors that have impacted, and are expected to continue to impact, earnings and cash flows for this business include:

- Our ability to control our capital expenditures, which primarily are limited to modifications to accommodate payload processing for new launch vehicles, maintenance and safety, environmental and reliability projects, and other costs, through disciplined management and safe, efficient operations

- The continuing limited availability of competing facilities at the major domestic launch sites that can offer compatible services, leading to an increase in government use of our services

- Our ability to complete customer specified facility modifications within budgeted costs and time commitments

SPACEHAB Government Services. For nearly 30 years, our Government Services business unit has provided large scale program technical support and specialized engineering analysis, products, and services to NASA and other customers. Our Government Services business unit derives most of its revenue under ARES contract to provide configuration and data management services within NASA s Program Integration & Control (PI&C) contract for the International Space Station. The base contract period extends through September 2008 and can be extended for two additional one year terms at the election of our NASA customer. Under this contract, we facilitate the assurance that the tens of thousands of pieces of hardware and software parts and components meet approved design and configuration requirements for the International Space Station. During the first nine months of fiscal year 2007, our Government Services business unit accounted for 11% of our consolidated revenues.

Earnings from our Government Services business unit are dependent on our ability to continue to win contracts with NASA or other government entities through the competitive bidding process and our performance under those contracts in achieving performance bonuses. Other factors that have impacted, and are expected to continue to impact earnings and cash flows for this business include:

- Continuation through 2008 of our PI&C contract with the International Space Station program and exercise of the contract options through 2010

- Our ability to maintain small business qualification for our Government Services business unit under NASA contracting rules

- Our ability to control costs within our budget commitments

Corporate and Other. Significant items impacting future earnings and cash flows include:

- Interest expense which has decreased due to the repayment of our mortgage debt during fiscal year 2006 and which will be further reduced if our Exchange Transaction (see Note 28) is successful

- Income taxes, with respect to which we currently only pay alternative minimum tax and minimal state income taxes; income taxes will be impacted by limitations on our net operating loss carry forward upon consummation of our Exchange Transaction, if successful (see Note 28)

New Business Vision

In anticipation of the planned 2010 space shuttle retirement, we began developing new products and services. We are now focusing our business on using our core capabilities for the commercial exploitation of space. These new business initiatives include the following:

- Processing products and services in microgravity;
- Commercializing products manufactured in microgravity;
- Commercializing products developed for use in the space industry;
- Acquiring other U.S. space contractors; and
- Providing end-to-end services for commercial and government satellite operations.

Although we are developing products and services in support of the new business visions, we currently do not have contracts or other arrangements to provide these products and services. We cannot assure you that we will be able to successfully develop these new products and services in the future. We anticipate that we will require substantial

additional capital to develop these new products and services, and that this additional financing will likely substantially dilute current holders of our common stock.

New Business Initiatives

Many of our identified new business initiatives are focused on space-based life sciences and end-to-end space mission assurance services, which are natural extensions of our 23 years of space industry experience and our core capabilities in these fields. These new business initiatives will require large investments of capital and technical expertise.

Microgravity. In the early days of the space program, it was determined that the effects of microgravity provide a unique environment that could potentially benefit humans. Since the inception of the Space Shuttle Program and extending through the International Space Station Program, NASA has spent billions of dollars on microgravity infrastructure and research. We have been logistically responsible for several hundred of these experiments on the space shuttle, the Russian Progress vehicle and the International Space Station.

Previous spaceflight research suggests that growing protein crystals in the microgravity environment of space offers the possibility of significantly increasing the x-ray diffraction quality of protein crystals. We believe that because of the high quality of these protein crystal structures, they may be used to better define the protein structures of diseases such as diabetes, cystic fibrosis, sickle cell anemia, Alzheimer s, Parkinson s disease, Lou Gehrig s disease and certain forms of cancer, which in turn may lead to the development of drugs capable of combating these diseases. If we are successful in developing protein crystals in microgravity, we expect to pre-sell these crystals to pharmaceutical companies.

On August 14, 2007, NASA announced that it was seeking private industry proposals for research and manufacturing concepts and opportunities onboard the International Space Station. This announcement indicates NASA s desire to open the International Space Station to commercial projects. Because of our experience with microgravity, we are responding to the solicitation and believe that we are well positioned to transition protein crystal growth, and other identified candidates, from a space research project to a fully commercialized microgravity processing operation.

Advanced Research and Conventional Technology Utilization Spacecraft (ARCTUS). We are assembling a team of industry partners with a common goal of developing a commercial transportation system providing lower cost, lower risk space transportation services than conventional, government-developed transportation systems. ARCTUS is designed to provide cargo transportation services to the International Space Station under the unfunded Space Act Agreement signed with NASA in June 2007.

End-to-End Space Mission Assurance. We believe that Astrotech is a recognized leader in providing commercial spacecraft processing services. Astrotech intends to expand its market by offering end-to-end assurance services to both commercial and government customers. These new end-to-end space mission assurance services would extend Astrotech s current relationships with customers spacecraft from a condensed few weeks of ground processing at an Astrotech facility to multiple years of space mission assurance services throughout the satellite s lifecycle.

SPACETECH. In 2007, we formed a technology incubator called SPACETECH. The purpose of SPACETECH is to cultivate technology developed for and from space into commercial applications. The following are two examples of new initiatives already underway within SPACETECH:

- Under an unfunded Space Act Agreement with NASA, we began development of a mini-mass spectrometer which we hope to turn into a small, portable, low power unit capable of detecting chemical compounds such as explosives, weapons of mass destruction, and toxic gases. We are negotiating an agreement for the licensing, sale and distribution of the mini mass spectrometer.

- The Federal Aviation Administration and Department of Transportation have enacted new regulations for air transportation of oxygen containers to enhance safety in the event of a fire. Applying decades of experience in the development of specialized containers, we have been working with an industry partner to develop and certify a

container to meet these new requirements. If successful, this project will provide us an opportunity to enter a new market.

Our Business Strategy

Our strategic vision is to be a recognized market leader in providing services to support space operations and utilization with consistent growth while increasing shareholder value. Our business strategies to achieve this are:

- Deliver excellence on current work, including providing technical support on space programs and remaining space shuttle missions;

- Leverage decades of experience facilitating bioscience space payloads and developing and operating successful space hardware for expansion into microgravity processing;

- Bring mature space technology and space-based processing to the commercial markets;

- Provide access to space on alternative launch systems for proprietary space processing and for commercial customers;

- Design solutions that encourage private commercial investment in space; and

- Continue to develop space-related hardware.

FINANCIAL CONDITION, CAPITAL RESOURCES, AND LIQUIDITY

Balance Sheet. Our total assets at June 30, 2007 were $72.5 million compared to total assets of $85.5 million at the end of fiscal year 2006. The following table sets forth the significant components of the balance sheet as of June 30, 2007, compared with 2006 (in thousands):

	2007	2006	Chg.
Assets:			
Current assets	$ 25,926	$ 20,675	$ 5,251
Property and equipment (net)	43,884	61,637	(17,753)
Other assets (net)	2,665	3,138	(473)
Total	$ 72,475	$ 85,450	
Liabilities and stockholders equity:			
Current liabilities	$ 31,471	$ 17,922	$ 13,549
Long-term debt-less current portion	52,944	63,250	(10,306)
Other long-term liabilities	1,191	1,469	(278)
Stockholders equity	(13,131)	2,809	(15,940)
Total	$ 72,475	$ 85,450	

Fiscal Year 2007 Compared to Fiscal Year 2006. Current assets as of June 30, 2007 increased by $5.3 million as compared to June 30, 2006. This increase is primarily due to:

- Increase in cash and restricted cash of $9.7 million which was partially offset by a decrease in accounts receivable of $3.1 million and other assets of $1.3 million. These differences are attributed to:

- Increase in cash and restricted cash of $9.7 million is primarily attributable to a new contract to expand our payload processing facility in our Astrotech subsidiary which generated $6.3 million in restricted cash during fiscal year 2007.

- Increase in cash of $3.4 million partially due to us receiving $3.1 million from our customer before year-end for the in-flight insurance on STS-118. The payment to the insurance carrier was made subsequent to year-end.

- Decrease in accounts receivable of $3.1 million is primarily attributable to the decreased volume of sales in Flight Services due to our contracted missions for our shuttle assets ending their contracted period of performance.

- Decrease in other assets of $1.3 million is primarily a result of us valuing our inventory to market prices. This resulted in a non-cash write-down of the inventory by $1.7 million.

- Increase in prepaid expenses of $0.3 million.

The decrease in net property and equipment of $17.8 million from June 30, 2007 to June 30, 2006 resulted primarily from the write-down of our flight unit 2 module due to our analysis of the remaining shuttle flights and the potential need for our flight unit 2 module on these flights and depreciation.

The decrease in other assets of $0.5 million from June 30, 2007 to June 30, 2006 resulted primarily from a decrease in net deferred financing costs of approximately $0.5 million as a result of amortization of the deferred financing costs. Additionally, we had a non-cash valuation allowance of $0.1 million for our investment in Applied Astronautical Corporation offset by an increase in other assets of $0.1 million.

Our current liabilities increased by $13.5 million from June 30, 2006 to June 30, 2007. The following summarizes significant items:

- Our accounts payable and accrued expenses decreased from $14.7 million to $11.0 million due a reduction in mission activities in our Flight Services business unit and the timing of payments.

- Our short-term debt decreased by $1.6 million from June 30, 2006 to June 30, 2007 as we paid the remaining payments on our mortgage loan at our Astrotech facility. Additionally, our short-term debt increased from June 30, 2006 to June 30, 2007 by $10.3 million due to our 8% convertible subordinated notes maturing in October 2007.

- Our advances on construction contract increased by $5.7 million from June 30, 2006 to June 30, 2007. The increase in advances on the construction contract was primarily due to receiving the initial milestone payments on our contract with a governmental agency to design and build a new processing facility and corresponding payments to subcontractors for work performed during the period.

- Our short-term deposit account increased by $3.1 million during the current fiscal year. This is a result of us receiving $3.1 million from our customer prior to year end for the in-flight insurance on our flight assets for STS-118 that flew in August 2007. The payment to the insurance carrier was made subsequent to year end.

- Our current portion of deferred revenue decreased by $0.2 million for June 30, 2006 to June 30, 2007 due to timing of receiving payments and recognizing revenue for shuttle related and satellite related programs.

Our long-term debt as of June 30, 2007 decreased by $10.3 million due to the maturity of $10.3 million of our 8% convertible subordinated notes in October 2007.

Other long-term liabilities decreased by $0.3 million at year end 2007 compared to year end 2006 primarily due to normal recognition of the long-term gain of the $1.6 million that was recorded in the fourth quarter of fiscal year 2005 due to the sale of our Cape Canaveral and Houston Headquarters facilities that will be recognized over the term of the leases.

Liquidity and Capital Resources

As of June 30, 2007 we had cash and restricted cash on hand of $16.0 million and our working capital was approximately ($5.5) million. Restricted cash, which consists of advance payments on a government contract to modify certain spacecraft processing facilities, totaled $6.3 million at June 30, 2007. For fiscal year 2007 we generated $12.3 million from operating activities. Our $5.0 million revolving credit facility expired as of February 11, 2007 and we elected not to renew the facility.

Our $10.3 million of outstanding 8.0% convertible notes are due on October 15, 2007 and our $52.9 million of 5.5% senior convertible notes are due in October 2010. A covenant in our 5.5% note indenture restricts us from using the proceeds from the sale or mortgage of our Astrotech Florida assets for purposes other than reducing outstanding balances on our credit facility, repaying our now extinguished mortgage loan, or redeeming outstanding 5.5% senior convertible notes. We do not have sufficient liquidity to repay the principal and interest on our 8.0% convertible notes and the interest on our 5.5% senior convertible notes when due on October 15, 2007 unless our Exchange Offer (see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources) is successfully consummated.

Cash Flows From Operating Activities. Cash provided by (used in) operations for the years ended June 30, 2007, 2006, and 2005 was $12.3 million, $4.0 million, and ($7.2) million, respectively. The significant items affecting the differences in cash flows from operating activities in fiscal year 2007 as compared to fiscal year 2006, and fiscal year 2006 compared to fiscal year 2005 are discussed below:

Fiscal Year 2007 Compared to Fiscal Year 2006. For the fiscal year 2007 compared to fiscal year 2006, the significant items affecting cash provided by operating activities were:

- Net loss for fiscal year 2007 was $16.3 million as compared to net loss for fiscal year 2006 of $12.4 million. Included in the net loss for fiscal year 2007 is a $12.5 million non-cash charge for the write-down of our flight unit 2 module and other shuttle related assets. Additionally, the net loss for fiscal year 2007 included a non-cash charge of

$0.1 million for the valuation of our investment in Applied Astronautics Corporation. Included in the net loss for fiscal year 2006 is a $6.3 million non-cash charge for the write-down of our flight unit 3 module.

- Fiscal year 2006 included a non-cash charge of $0.6 million related to the acceleration of debt placement costs related to the original issuance costs of our $63.3 million 8% convertible subordinated costs to the exchange of $52.9 million of the notes for $52.9 million of 5.5% senior convertible subordinated notes.

- Depreciation and amortization for fiscal year 2007 was $0.3 million more compared to fiscal year 2006, primarily due to increased depreciation expense for our flight assets resulting from the change of the

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depreciable lives from 2016 to 2010. This change in depreciable lives is based on the most current information available from NASA on the retirement of the space shuttle fleet at the end of 2010.

- Changes in assets for fiscal year 2007 provided cash from operations of $4.3 million. This change is primarily due to:

- Decrease in accounts receivable of $4.6 million which is primarily due to a decrease in shuttle-related project work and the timing of payments.

- Increase in prepaid expenses and other assets of $0.3 million which is mainly due to increased mission activities in our Astrotech business unit for future satellite processing missions.

- Changes in assets for fiscal year 2006 provided cash from operations of $5.6 million. This change is primarily due to:

- Decrease in accounts receivable of $5.5 million which is primarily due to a decrease in shuttle-related project work and the timing of payments.

- Decrease in prepaid expenses and other assets of $0.1 million which is primarily due to a decrease in deferred mission costs for the Japanese Experiment Thermal Incubator Service contract due to the completion of the contract in fiscal year 2006.

- Changes in liabilities for fiscal year 2007 provided cash from operations of $5.3 million. This change is primarily due to:

- Decreases in accounts payable, accrued expenses, and accrued subcontracting costs of $3.3 million which is due to decreased mission activity for shuttle related projects.

- Decrease in deferred revenue of $0.2 million. The decrease in deferred revenue is primarily due to the timing of mission activities and payments in Astrotech business unit.

- Increase in advances on construction contract of $5.7 million. The increase for our advances on the construction contract increased by $5.7 million due to receiving the initial milestone payments on our contract with a governmental agency to design and build a new processing facility and corresponding payments to subcontractors for work performed during the period.

- Increase of $3.1 million in customer deposits. Our short-term deposit account increased by $3.1 million during the current fiscal year. This is a result of us receiving $3.1 million from our customer prior to year end for the in-flight insurance on our flight assets for STS-118 that flew in August 2007. The payment to the insurance carrier was made subsequent to year end.

Changes in liabilities for fiscal year 2006 used cash from operations of $2.2 million. This change was due primarily to the decreases in accounts payable, accrued expenses, and accrued subcontracting costs of $1.8 million and the decrease in deferred revenue of $0.4 million. The decreases in accounts payable, accrued expenses, and accrued subcontracting costs is due to decreased mission activity for shuttle related projects. The decrease in deferred revenue is primarily due to the completion of the Japanese Experiment Thermal Incubator Service contract during fiscal year 2006.

Fiscal Year 2006 Compared to Fiscal Year 2005. For the fiscal year 2006 compared to fiscal year 2005, the significant items affecting cash provided by operating activities were:

- Net loss for fiscal year 2006 was $12.4 million as compared to net income for fiscal year 2005 of $5.2 million. Included in the net loss for fiscal year 2006 is a $6.3 million non-cash charge for the write-down of our flight unit 3 module. Included in net income for fiscal year 2005 is $7.7 million recognized as a net recovery of a previously reported non-recurring loss of our research double module destroyed during the Space Shuttle *Columbia* mission.

- Fiscal year 2006 non-cash charge of $0.6 million related to the acceleration of debt placement costs related to the original issuance costs of our $63.3 million 8% convertible subordinated costs to the exchange of $52.9 million of the notes for $52.9 million of 5.5% senior convertible subordinated notes.

- Depreciation and amortization for fiscal year 2006 was $0.5 million more compared to fiscal year 2005, primarily due to increased depreciation expense for our flight assets resulting from the change of the depreciable lives from 2016 to 2010. This change in depreciable lives is based on the most current information available from NASA on the retirement of the space shuttle fleet at the end of 2010. This increase is partially offset by a portion of assets reaching the end of their useful lives and decreased depreciation expense due to the sale of our facility in Cape Canaveral, Florida during fiscal year 2005.

- Changes in assets for fiscal year 2006 provided cash from operations of $5.6 million. This change is primarily due to a decrease in accounts receivable of $5.5 million and a decrease in prepaid expenses and other assets of $0.1 million. The decrease in accounts receivable is primarily due to a decrease in shuttle-related project work

and the timing of payments. The decrease in other assets is primarily due to a decrease in deferred mission costs for the Japanese Experiment Thermal Incubator Service contract due to the completion of the contract in fiscal year 2006. For fiscal year 2005 change in assets used cash from operations of $7.9 million primarily from an increase in accounts receivable of $9.0 million and an increase in prepaid expenses of $0.2 million, which was partially offset by a decrease in other assets of $1.3 million.

- Changes in liabilities for fiscal year 2006 used cash from operations of $2.2 million. This change is due primarily to the decreases in accounts payable, accrued expenses, and accrued subcontracting costs of $1.8 million and the decrease in deferred revenue of $0.4 million. The decreases in accounts payable, accrued expenses, and accrued subcontracting costs is due to decreased mission activity for shuttle related projects. The decrease in deferred revenue is primarily due to the completion of the Japanese Experiment Thermal Incubator Service contract during fiscal year 2006. For fiscal year 2005 changes in liabilities used cash in operations of $1.8 million. This change is due primarily to the decreases in accounts payable and accrued expenses of $1.5 million which includes an increase due to the recording of $0.5 million related to the Lloyd s settlement and the decrease in deferred revenue of $5.4 million.

Cash Flows From Investing Activities. For the years ended June 30, 2007, 2006, and 2005, cash flows provided by (used in) investing activities were ($7.4) million, ($1.1) million, and $17.7 million, respectively. The significant items affecting the differences in cash flows from investing activities in fiscal year 2007 compared to fiscal year 2006 and fiscal year 2006 compared to fiscal year 2005 are as follows:

Fiscal Year 2007 Compared to Fiscal Year 2006. For the fiscal year 2007 compared to fiscal year 2006, the significant items affecting cash provided by (used in) investing activities were:

- Property and equipment purchases of $0.6 million for fiscal 2007 as compared to $2.1 million for fiscal year 2006. This reduction is a continuation of our efforts to reduce capital expenditures.

- Fiscal year 2007 cash flows from investing activities included a $0.5 million payment to Lloyd s of London as a result of our claim dismissal against NASA for the loss of our RDM.

- Fiscal year 2007 cash flows from investing activities included an increase of $6.3 million in restricted cash as compared to a decrease in restricted cash of $0.1 million for fiscal year 2006. This difference is a result of us receiving payments during fiscal year 2007 for the design and construction of a payload processing facility at our Vandenberg Air Force Base location.

Fiscal Year 2006 Compared to Fiscal Year 2005. For the fiscal year 2006 compared to fiscal year 2005, the significant items affecting cash provided by (used in) investing activities were:

- Property and equipment purchases of $2.1 million for fiscal 2006 as compared to $3.4 million for fiscal year 2005. For fiscal year 2005 cash flows from investing activities included the purchase of the Houston Headquarters facility that was subsequently sold and leased back from the new landlord.

- Fiscal year 2005 cash flows from investing activities were generated from the sale of short-term investments of $6.6 million as compared to no sales of such short-term investments for the fiscal year 2006.

- Fiscal year 2005 cash flows from investing activities included $8.2 million received from NASA under the Research and Logistics Mission Support contract indemnification clause for the loss of our RDM.

- Fiscal year 2005 cash flows from investing activities included $6.8 million from the sale of our Cape Canaveral and Headquarters facilities.

- Fiscal year 2006 cash flows from investing activities included a decrease of $1.0 million in restricted cash as compared to an increase in restricted cash of $0.5 million for fiscal year 2005.

Cash Flows From Financing Activities. For the years ended June 30, 2007, 2006, and 2005, cash flows used in financing activities were $1.5 million, $3.9 million, and $3.7 million, respectively. The significant items affecting the differences in cash flows from financing activities in fiscal year 2007 compared to fiscal year 2006 and fiscal year 2006 compared to fiscal year 2005 are as follows:

Fiscal Year 2007 Compared to Fiscal Year 2006. For the fiscal year 2007 compared to fiscal year 2006, the significant items affecting cash used in financing activities were:

- Fiscal year 2007 had a payment of $1.6 million for our mortgage loan as compared to payments of $2.1 million for fiscal year 2006. This decrease is due to the maturity of the term note in January 2007 and complete payment in December 2006.

- Fiscal year 2006 had an increase of $1.9 million from the refinancing of our subordinated convertible notes as compared to fiscal year 2007.

Fiscal Year 2006 Compared to Fiscal Year 2005. For the fiscal year 2006 compared to fiscal year 2005, the significant items affecting cash used in financing activities were:

- Fiscal year 2005 had net repayments of $1.4 million in principal under our revolving credit facility as compared to no borrowings for fiscal year 2006.

- Fiscal year 2006 had a payment of $2.1 million for our mortgage loan as compared to payments of $1.9 million for fiscal year 2005. This increase is due to the term of the mortgage loan approaching its maturity date of January 2007.

- Fiscal year 2006 had an increase of $1.5 million from the refinancing of our subordinated convertible notes as compared to fiscal year 2005.

Liquidity. We continue to focus our efforts on improving overall liquidity through identifying new business opportunities within the areas of our core competencies, reducing operating expenses, and limiting cash commitments for future capital investments and new asset development. We have continued to restrict new capital investment and new asset development, limiting projects to those required to support current contracts and facility maintenance. Additionally, we continue to evaluate operating expenses in an effort to reduce or eliminate costs not required for us to operate effectively.

On April 28, 2005 we consummated the sale and simultaneous lease back of our Cape Canaveral, Florida payload processing facility. The sale resulted in net cash of approximately $3.8 million. We leased back the facility for an initial period of five years, with an option period of an additional five years. The annual rental for the first five years of this lease is approximately $0.45 million. On May 26, 2005 we consummated the sale and lease back of our corporate offices in Webster (Houston), Texas. The sale resulted in net cash of approximately $0.9 million. We leased back 100% of the facility for an initial period of ten years, with two five-year options. We also retained the adjacent 3.0 acre parcel for future development or sale. The annual rental for the first year of this lease is approximately $0.3 million and gradually increases through the tenth year of the lease to approximately $0.4 million.

Our cash and restricted cash on hand was approximately $16.0 million as of June 30, 2007. Included in the $16.0 million is $3.1 million for in-flight insurance on STS-118 that was paid in July 2007. Additionally, $6.3 million is restricted cash for a construction contract to expand one of our processing facilities. Our capital requirements for continuing operations consist of our general working capital needs, scheduled principal and interest payments on our debt obligations, certain contractual commitments, and capital expenditures. This includes short-term capital to finance continuing operations at the end of 2007, and long-term capital to finance our growth. Our capital resources which are solely comprised of cash reserves and cash generated from operations may not be sufficient to meet these capital requirements. While we believe that the exchange offer would help address our foreseeable refinancing risk related to the Junior Notes that mature in October 2007, there is no assurance that the exchange offer will be sufficient to alleviate our liquidity issues due to a lack of capital resources. In addition, with the conclusion of STS-118 in August 2007, we expect to have a material decrease in our revenue from our Flight Services business, which has accounted for over 65% of our consolidated revenue during fiscal year 2007. Moreover, our revolving credit line expired on February 11, 2007. As a result, in order to continue to fund our current operations, we will need additional capital. No assurance can be given that we will be able to obtain a new source of capital on terms that are acceptable to us. If we are unable to obtain new capital, we may be forced to subject ourselves to bankruptcy, reorganization, liquidation, dissolution or similar proceeding.

If we are unable to complete the Exchange Offer for any reason, we may restructure through a bankruptcy proceeding. Our ability to restructure in bankruptcy is subject to numerous risks, including the following:

- We may lose customers in bankruptcy because our services are critical to our customers businesses

- The costs of bankruptcy will significantly exceed the costs of an out-of-court transaction

- We may be unable to arrange debtor-in-possession financing or otherwise finance our operations during bankruptcy

Our capital requirements for continuing operations consist of our general working capital needs, scheduled principal and interest payments on our debt obligations, certain contractual commitments, and capital expenditures. This includes short-term capital to finance continuing operations at the end of 2007, and long-term capital to finance our

growth. Our capital resources which are solely comprised of cash reserves and cash generated from operations, may not be sufficient to meet these capital requirements. While we believe that the exchange offer would help address our foreseeable refinancing risk related to the Junior Notes that mature in October 2007, there is no assurance that the exchange offer will be sufficient to alleviate our liquidity issues due to a lack of capital resources.

Our contractual obligations as of June 30, 2007 are as follows (in thousands):

Contractual Obligations	At June 30, 2007	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012	Thereafter
Short-term Debt	$ 10,306	$ 10,306	$		$	$	$
Long-term Debt	52,944				52,944		
ICC/VCC	1,389	1,389					
Operating leases(1)	12,579	2,662	970	982	769	547	6,649
Total Contractual Cash Obligations	$ 77,218	$ 14,357	$ 970	$ 982	$ 53,713	$ 547	$ 6,649

(1) For fiscal years 2008 and 2009 we expect to receive net payments of approximately $0.4 million and $0.1 million, respectively, for subleases. Additionally, we agreed to terminate out ICC and VCC leases (see Note 28) in FY2008.

Critical Accounting Policies

Revenue Recognition. Our business units revenue is derived primarily from long-term contracts with the U.S. Government and commercial customers. Revenues under these contracts are recognized using the methods described below. Estimating future costs and, therefore, revenues and profits is a process requiring a high degree of management judgment. Risk See Factors Risks Related to Our Business Our financial results could be affected if the estimates that we use in accounting for contracts are incorrect and need to be changed. We base our estimate on historical experience and on various assumptions that are believed to be reasonable under the circumstances including the negotiation of equitable adjustments on our fixed-price contracts due to launch delays. Costs to complete include, when appropriate, material, labor, subcontracting costs, lease costs, commissions, insurance, and depreciation. Our business units personnel perform periodic contract status and performance reviews. In the event of a change in total estimated contract cost or profit, the cumulative effect of such change is recorded in the period that the change in estimate occurs.

A Summary of Revenue Recognition Methods Follows:

Business Unit	Services/Products Provided	Contract Type	Method of Revenue Recognition
Flight Services	Commercial Space Habitat Modules, Integration & Operations Support Services	Firm Fixed Price	Percentage-of-completion based on costs incurred
Astrotech	Payload Processing Facilities	Firm Fixed Price Mission Specific	Ratably, over the occupancy period of a satellite within the facility from arrival through launch
		Firm Fixed Price Guaranteed Number of Missions	For multi-year contract payments recognized ratably over the contract period

Government Services	Configuration Management, Engineering Services	Cost Reimbursable Award/Fixed Fee	Reimbursable costs incurred plus award/fixed fee

Long-Lived Assets. In assessing the recoverability of long-lived assets, fixed assets, assets under construction and intangible assets, we evaluate the recoverability of those assets in accordance with the provisions of the Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This Statement requires that certain of our long-lived fixed assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized

is measured by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

RESULTS OF OPERATIONS

Results of Operations for the Years Ended June 30, 2007, 2006, and 2005

Overview. In this section we discuss our results of operations, both on a consolidated basis and, where appropriate, by business unit for our fiscal years ended June 30, 2007, 2006, and 2005. Where we report earnings or loss on a per share basis, we have done so on a diluted earnings per share basis. The weighted average number of common shares applicable to diluted earnings for 2007, 2006, and 2005 were 12,919,506, and 12,743,533, and 14,190,281, respectively.

We had net income (loss) of ($16,292,000) or ($1.26) per diluted share on revenues of $52,762,000 for our 2007 fiscal year compared to ($12,397,000) or ($0.97) per diluted share on revenues of $50,746,000 for 2006 and $5,249,000 or $0.37 per diluted share on revenues of $59,401,000 for 2005.

Revenue. Our revenue for the twelve months ended June 30, 2007, 2006, and 2005 was generated primarily from the Lockheed Martin Cargo Mission Contract and contracts with related commercial customers in the Flight Services business unit; the PI&C contract in our Government Services business unit; and our contracts with Lockheed Martin, Boeing, NASA, and other commercial satellite providers in our Astrotech business unit.

During fiscal year 2007, our Flight Services business unit supported NASA s spaceflight activities on both the STS-116 and 118 missions. Our Flight Services business unit prepared a cargo carrier for shuttle mission STS-118, the External Stowage Platform 3 (ESP3) that was deployed and permanently mounted to the International Space Station during the August 2007 mission. For both STS-116 and 118 missions under the Cargo Mission Contract, we provided our pressurized single module and unpressurized integrated cargo carrier for transport of critical cargo and orbital replacement units to and from the International Space Station.

During the three and twelve months ended June 30, 2007, deferred revenue decreased by $0.2 million and $0.2 million, respectively, as we recognized revenue on contracts where milestone payments had been received in prior periods. We expect further reduction of deferred revenue due to customer prepayments through the next twelve months which will result in revenue recognition on contracts for which the related cash was received in a prior period.

Costs of Revenue. We have several types of costs of revenue in our business segments. Costs of revenue for our Flight Services business unit include integration and operations expenses associated with the performance of two types of efforts, sustaining engineering in support of all missions under a contract and mission specific support. Costs associated with the performance of the contracts using the percentage-of-completion method of revenue recognition are expensed as incurred. Costs associated with the cost-reimbursable award and fixed-fee contracts are expensed as incurred by our Government Services business unit. Other costs of revenue include depreciation expense and costs associated with the Astrotech payload processing facilities. Flight-related insurance covering transportation of our modules from our payload processing facility to the space shuttle and third-party liability insurance are also included in costs of revenue and are recorded as incurred. Selling, general and administrative and interest and other expenses are recognized when incurred.

Non-GAAP Financial Measures. We use income from operations before charges as one measure of financial performance. Income from operations before charges is a non-GAAP financial measure and consists of operating income before unusual and infrequent events such as: goodwill impairments, asset impairments, investment impairments and the loss of the research double module. Income from operations before charges also does not include interest expense or income taxes, each of which is evaluated on a consolidated basis. Because we do not allocate interest expense and income taxes by unit, we believe that income from operations is a useful measure of our units operating performance for investors. Income from operations before charges should not be considered an alternative to, or more meaningful than, net income or cash flows from operations as determined in accordance with GAAP. The Other column in the

presentation below is our corporate selling, general and administrative expenses that are incurred for our overall operations that are not allocable to any specific business unit and results of operations for our SMI segment.

The following tables provide summary financial data regarding our consolidated and segmented results of operations for our 2007, 2006, and 2005 fiscal years, respectively (in millions):

Fiscal Year Ended June 30, 2007

	Flight Services Business Unit	Astrotech Business Unit	Government Services Business Unit	Other	Total
Income (loss) from operations before charges	$ 4.9	$ 2.0	$ 0.9	$ (8.0)	$ (0.2)
Asset impairment charge	(12.5)			(0.1)	(12.6)
Operating income (loss)	(7.6)	2.0	0.9	(8.1)	(12.8)
Other income/expense, net		0.1		0.6	0.7
Interest expense				(4.3)	(4.3)
Pre-tax income (loss)	(7.6)	2.1	0.9	(11.8)	(16.4)
Income tax benefit				0.1	0.1
Net income (loss)	$ (7.6)	$ 2.1	$ 0.9	$ (11.7)	$ (16.3)

Fiscal Year Ended June 30, 2006

	Flight Services Business Unit	Astrotech Business Unit	Government Services Business Unit	Other	Total
Income (loss) from operations before charges	$ 4.7	$ 2.5	$ 0.5	$ (8.6)	$ (0.9)
Asset impairment charge	(6.3)				(6.3)
Operating income (loss)	(1.6)	2.5	0.5	(8.6)	(7.2)
Other income/expense, net				0.3	0.3
Interest expense				(5.5)	(5.5)
Pre-tax income (loss)	(1.6)	2.5	0.5	(13.8)	(12.4)
Income tax expense					
Net income (loss)	$ (1.6)	$ 2.5	$ 0.5	$ (13.8)	$ (12.4)

Fiscal Year Ended June 30, 2005

	Flight Services Business Unit	Astrotech Business Unit	Government Services Business Unit	Other	Total
Income (loss) from operations before charges	$ 7.6	$ 2.1	$ 0.9	$ (7.8)	$ 2.8
Non recurring item net recovery	7.7				7.7
Operating income (loss)	15.3	2.1	0.9	(7.8)	10.5
Other Income/expense, net		0.1		0.2	0.3

Interest expense				(5.7)	(5.7)
Pre-tax income (loss)	15.3	2.2	0.9	(13.3)	5.1
Income tax benefit				0.1	0.1
Net income (loss)	$ 15.3	$ 2.2	$ 0.9	$ (13.2)	$ 5.2

Operating Income (Loss). Operating income (loss) was ($12.8) million in fiscal year 2007, compared to ($7.2) million and $10.5 million for fiscal years 2006 and 2005, respectively. The following summarizes the activity in each of our operating segments:

SPACEHAB Flight Services

Operating income (loss) for our Flight Services business unit was ($7.6) million for fiscal year 2007, compared to ($1.6) million and $15.3 million for fiscal years 2006 and 2005, respectively. Operating loss for 2007 included an asset impairment charge of $12.5 million for the write down of our flight unit 2 module and other flight based assets due to our analysis of the remaining space shuttle flights and NASA s potential need for our module. Operating loss for 2006 included an asset impairment charge of $6.3 million for the write down of our flight unit 3 module due to our analysis of the remaining space shuttle flights and NASA s potential need for our module. Operating income for fiscal year 2005 includes an $8.2 million payment from NASA for the loss of our RDM in the Space Shuttle *Columbia* accident. It also includes $0.5 million expense for our settlement with Lloyd s (see Item 3 Legal Proceedings for more details). Operating income for 2007 included general and administrative expense of $1.2 million and depreciation and amortization expense of $3.6 million as compared to general and administrative expenses of $1.0 million and $0.5 million and depreciation and amortization expense of $3.2 million and $2.8 million for fiscal years 2006 and 2005, respectively. Please see Results of Operations for the Years Ended June 30, 2007, 2006, and 2005 Other for a consolidated discussion of general and administrative expense and depreciation and amortization expense.

Flight Services Business Unit Results of Operations for the Fiscal Year Ended June 30, 2007 as Compared to the Fiscal Year Ended June 30, 2006

The Flight Services business unit s operating income before charges increased by $0.2 million from fiscal year 2006 to fiscal year 2007. The following summarizes significant changes for our fiscal year ended June 30, 2007 as compared to our fiscal year ended June 30, 2006:

Revenue increases of $1.1 million, consisting of the following

- Increase in revenue from STS-116 and STS-118 under the CMC with Lockheed Martin of $9.4 million due to increased mission activities and change orders due to the launch of STS-116 in December 2006 and the launch of STS-118 in August 2007.

- Decrease in revenue from External Stowage Platform 2 (ESP2) of $1.0 million due to the launch of STS-114 in July 2005.

- Decrease in revenue from STS-121 of $5.3 million due to the launch of STS-121 in July 2006.

- Decrease in revenue from the JETIS contract of $1.0 due to the contract being completed during fiscal year 2006.

- Decrease in revenue from the Concept Exploration and Refinement (CE&R) contract of $0.4 million due to the contract being completed during fiscal year 2006.

- Other contract revenue decrease of $0.6 million mainly due to our contract with Astrium to provide a new ICC pallet to replace ESP2 that was permanently affixed to the space station during the STS-114 mission in July 2005.

Cost of Revenue decreases of $0.9 million, consisting of the following:

- Increase in cost of revenue for STS-116 and STS-118 under the CMC with Lockheed Martin, other than depreciation expense, of $5.5 million due to increased mission activities due to the launch of STS-116 in December 2006 and the scheduled launch of STS-118 in August 2007.

- Decrease in cost of revenue of $4.4 million for STS-121 due to the launch of STS-121 in July 2006.

- Decrease in cost of revenue of $0.8 million from External Stowage Platform 2 of $0.3 million due to the launch of STS-114 in July 2005.

- Decrease in cost of revenue for the JETIS contract of $0.5 million due to the contract being completed during fiscal year 2006.

- Decrease in cost of revenue from the Concept Exploration and Refinement (CE&R) contract of $0.2 million due to the contract being completed during fiscal year 2006.

- Other cost of revenue decrease of $0.5 million mainly due to our contract with Astrium to provide a new ICC pallet to replace ESP2 that was permanently affixed to the space station during the STS-114 mission in July 2005.

Included in the revenue decreases is the reduction in workforce for our Flight Services business unit in January 2007. This reduction resulted in a net decrease in personnel and related costs of $1.3 million for the last six months of fiscal year 2007.

Our Flight Services business unit is currently supporting deintegration requirements for shuttle mission STS-118. The Flight Services business unit completed cargo services on the STS-121 mission that launched during the first part of fiscal year 2007. For the space shuttle STS-121 mission, we provided our non-deployable ICC to NASA for transport of several critical International Space Station orbital replacement unit spares. For bot