

Edgar Filing: AMERICAN AMMUNITION INC/FL - Form 10QSB/A

AMERICAN AMMUNITION INC/FL  
Form 10QSB/A  
October 22, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

Form 10-QSB/A

(Mark one)

Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: March 31, 2007

Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

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

Commission File Number: 0-32379

American Ammunition, Inc.

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

Nevada

91-2021594

-----  
(State of incorporation)

-----  
(IRS Employer ID Number)

3545 NW 71st Street, Miami, FL 33147

-----  
(Address of principal executive offices)

(305) 835-7400

-----  
(Issuer's telephone number)

=====  
Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

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

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: As of September 17, 2007:, the Transfer Agent's records indicate that there are 28,372,922 shares outstanding. Of these shares, a total of 21,803,335 shares were subject to an escrow agreement referenced in later filings.

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Transitional Small Business Disclosure Format (check one): YES  NO

American Ammunition, Inc.  
Form 10-QSB/A for the Quarter ended March 31, 2007

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PART I - FINANCIAL INFORMATION

ITEM 1 - Financial Statements

The March 31, 2007 and 2006 financial statements have been restated to account for the derivative liability that was incurred in connection with the common stock conversion features and the warrants issued with certain notes payable.

American Ammunition, Inc. and Subsidiaries  
Consolidated Balance Sheets  
March 31, 2007 and 2006  
(Unaudited)

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	(Restated) March 31, 2007	(Restated) March 31, 2006
	-----	-----
ASSETS		
Current Assets		
Cash on hand and in bank	\$ 700,546	\$ 289,712
Accounts receivable - trade, net of allowance for doubtful accounts of \$-0- and \$12,463, respectively	222,944	230,234
Inventory	634,139	425,337
Prepaid interest	172,456	339,253
Prepaid expenses	56,857	64,936
	-----	-----
Total Current Assets	1,786,992	1,349,472
	-----	-----
Property and Equipment - at cost		
Manufacturing equipment	7,984,501	8,126,135
Office furniture and fixtures	71,437	69,889
Leasehold improvements	184,939	190,277
	-----	-----
	8,240,877	8,386,301
Accumulated depreciation	(5,617,158)	(5,608,472)
Impairment of recoverability of carrying value	(2,623,719)	(2,777,829)
	-----	-----
Net Property and Equipment	-	-
	-----	-----
Other Assets		
Patents, Trademarks and Noncompetition agreement, net of accumulated amortization of approximately \$133,251 and \$78,112, respectively	142,439	197,578
Loan costs and fees, net of accumulated amortization of approximately \$65,250 and \$24,795	-	40,455
Deposits and other	83,660	83,660
	-----	-----
Total other assets	226,099	321,693
	-----	-----
TOTAL ASSETS	\$ 2,013,091	\$ 1,671,165
	=====	=====

- Continued -

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

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American Ammunition, Inc. and Subsidiaries  
 Consolidated Balance Sheets - Continued  
 March 31, 2007 and 2006  
 (Unaudited)

	(Restated) March 31, 2007	(Restated) March 31, 2006
	-----	-----
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Notes payable to shareholders	\$ -	\$ 975,000
Working capital advance	-	200,000
Convertible debenture	-	226,365
Customer deposits	87,729	188,020
Accounts payable - trade	785,270	1,042,892
Accrued salaries and wages	447,315	253,552
Federal excise taxes payable	38,734	-
Accrued interest payable	53,209	28,361
Accrued dividends payable	78,802	39,780
	-----	-----
Total Current Liabilities	1,491,059	2,953,970
<b>Long-Term Liabilities</b>		
Notes payable to shareholders	1,075,000	-
Derivative liabilities from note conversion features	2,655,282	3,284,149
Federal excise taxes payable	273,000	-
	-----	-----
Total Long-Term Liabilities	4,003,282	3,284,149
	-----	-----
Total Liabilities	5,494,341	6,238,119
	-----	-----
<b>Commitments and Contingencies</b>		
<b>Stockholders' Equity</b>		
Preferred stock - \$0.001 par value		
20,000,000 shares authorized.		
1,795,320 shares allocated to Series A		
91,700 shares allocated to Series B		
1,905,882 shares allocated to Series C		
200,000 shares allocated to Series E	2,004	2,040
Common stock - \$0.001 par value.		
300,000,000 shares authorized.		
23,007,902 and 4,440,714 shares		
issued and outstanding, respectively	23,018	4,441
Additional paid-in capital	33,706,178	25,654,502
Accumulated other comprehensive loss	(1,885,912)	(2,706,397)
Accumulated deficit	(35,326,538)	(27,346,540)
	-----	-----
Stock subscription receivable	(3,481,250)	(4,391,954)
	-	(175,000)
	-----	-----
Total Stockholders' Equity	(3,481,250)	(4,566,954)
	-----	-----
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 2,013,091</b>	<b>\$ 1,671,165</b>
	=====	=====

The accompanying notes are an integral part

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of these consolidated financial statements.

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American Ammunition, Inc. and Subsidiaries  
 Consolidated Statements of Operations and Comprehensive Loss  
 Three months ended March 31, 2007 and 2006  
 (Unaudited)

	(Restated) Three months ended March 31, 2007	(Restated) Three months ended March 31, 2006
	-----	-----
Revenues - net of returns and allowances	\$ 690,389	\$ 710,111
	-----	-----
Cost of Sales		
Materials, Direct Labor and other direct costs	875,763	1,347,081
Depreciation	41,376	31,024
	-----	-----
Total Cost of Sales	917,139	1,378,105
	-----	-----
Gross Profit	(226,750)	(667,994)
	-----	-----
Operating Expenses		
Research and development expenses	567	-
Marketing and selling expenses	32,372	55,817
Other operating expenses	274,758	374,908
Interest expense	28,003	150,329
Amortization expense	13,785	13,785
	-----	-----
Total Operating Expenses	349,485	594,839
	-----	-----
Loss from Operations	(576,235)	(1,262,833)
Other Income (Expense)	89	41,557
	-----	-----
Loss before Income Taxes	(576,146)	(1,221,276)
Provision for Income Taxes	-	-
	-----	-----
Net Loss	(576,146)	(1,221,276)
	-----	-----
Other Comprehensive Income		
Change in derivative related to note conversion	2,402,259	(2,748,947)
	-----	-----
Comprehensive Loss	\$ 1,466,113	\$ (3,970,223)
	=====	=====
Preferred Stock Dividends	(13,040)	(12,050)
	-----	-----
Net Loss available to Common Shareholders	\$ (589,186)	\$ (1,233,326)
	=====	=====
Loss per weighted-average share of common stock outstanding, computed on net loss available to common shareholders - basic and fully diluted	\$ (0.03)	\$ (0.29)
	=====	=====
Weighted-average number of common shares outstanding	23,015,580	4,270,491

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

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American Ammunition, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows  
 Three months ended March 31, 2007 and 2006  
 (Unaudited)

	(Restated) Three months ended March 31, 2007	(Restated) Three months ended March 31, 2006
	-----	-----
Cash flows from operating activities		
Net loss for the period	\$ (576,146)	\$ (1,221,276)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	64,742	171,377
Expenses paid with common stock	-	18,325
(Increase) Decrease in		
Accounts receivable	173,644	341,193
Inventory	(124,035)	134,753
Prepaid expenses, deposits and other	2,202	(8,147)
Increase (Decrease) in		
Customer deposits	(102,111)	-
Accounts payable - trade	50,009	196,275
Other accrued expenses	44,501	(17,813)
	-----	-----
Net cash (used in) operating activities	(467,194)	(385,313)
	-----	-----
Cash flows from investing activities		
Purchase of property and equipment	(41,376)	(31,025)
	-----	-----
Net cash (used in) investing activities	(41,376)	(31,025)
	-----	-----
Cash flows from financing activities		
Cash received on working capital advance	-	50,000
Cash received from sale of preferred stock	-	250,000
Cash paid to acquire capital	-	(50,000)
	-----	-----
Net cash provided by financing activities		275,000
	-----	-----
Increase (Decrease) in Cash	(508,570)	(141,338)
Cash at beginning of period	1,209,116	431,050
	-----	-----
Cash at end of period	\$ 700,546	\$ 289,712
	=====	=====
Supplemental disclosure of interest and income taxes paid		

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Interest paid for the period	\$	-	\$ 4,525
Income taxes paid for the period	\$	-	\$ -
Supplemental disclosure of non-cash investing and financing activities			
Issuance of common stock to pay accrued interest	\$	-	\$ 17,261
Issuance of common stock to pay accrued dividends	\$	4,874	\$ -

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

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
March 31, 2007 and 2006

### Note A - Organization and Description of Business

American Ammunition, Inc. (AAI or Company) was incorporated on February 1, 2000 in accordance with the Laws of the State of California. The Company functions as a holding company providing management oversight services to it's wholly-owned operating subsidiaries; F&F Equipment, Inc. and Industrial Plating Enterprise Co.

F&F Equipment, Inc.(F&F) was incorporated on October 4, 1983 in accordance with the Laws of the State of Florida. F&F is engaged in the design, manufacture and international sales of small arms ammunition. F&F has conducted its business operations under the assumed name of "American Ammunition" since its inception.

Industrial Plating Enterprise Co. (IPE), which was incorporated and commenced production on June 14, 2002. IPE is a fully licensed and approved state of the art electrochemical metallization facility for processing the Company's line of small arms projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques. The facility meets or exceeds all current environmental requirements and enjoys the "conditionally exempt small quantity generator" status for State and Federal regulations. All activities of IPE since it's inception have been dedicated to the needs and demands of F&F.

On January 9, 2006, by written consent in lieu of meeting, a majority of the Company's stockholders approved a recommendation by the Company's Board of Directors to effect a one share for twenty shares reverse stock split of our common stock, par value \$.001 per share, with fractional shares rounded up to the nearest whole share. The reverse split became effective on that date. As a result of the reverse split, the total number of issued and outstanding shares of the Company's common stock decreased from 92,576,839 to 4,629,381shares, after giving effect to rounding for fractional shares. The effect of this action is reflected in the Company's financial statements as of the first day of the first period presented.

### Note B - Preparation of Financial Statements

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The Company and its subsidiaries follow the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and have adopted a year-end of December 31 for all entities.

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

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### American Ammunition, Inc. and Subsidiaries Notes to Consolidated Financial Statements - Continued March 31, 2007 and 2006

#### Note B - Preparation of Financial Statements - Continued

Management further acknowledges that it is solely responsible for adopting sound accounting practices, establishing and maintaining a system of internal accounting control and preventing and detecting fraud. The Company's system of internal accounting control is designed to assure, among other items, that 1) recorded transactions are valid; 2) valid transactions are recorded; and 3) transactions are recorded in the proper period in a timely manner to produce financial statements which present fairly the financial condition, results of operations and cash flows of the Company for the respective periods being presented

During interim periods, the Company follows the accounting policies set forth in its annual audited financial statements filed with the U. S. Securities and Exchange Commission on its Annual Report on Form 10-KSB for the year ended December 31, 2006. The information presented within these interim financial statements may not include all disclosures required by generally accepted accounting principles and the users of financial information provided for interim periods should refer to the annual financial information and footnotes when reviewing the interim financial results presented herein.

In the opinion of management, the accompanying interim financial statements, prepared in accordance with the U. S. Securities and Exchange Commission's instructions for Form 10-QSB, are unaudited and contain all material adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial condition, results of operations and cash flows of the Company for the respective interim periods presented. The current period results of operations are not necessarily indicative of results which ultimately will be reported for the full fiscal year ending December 31, 2007.

For segment reporting purposes, the Company operated in only one industry segment during the periods represented in the accompanying financial statements and makes all operating decisions and allocates resources based on the best benefit to the Company as a whole.

The accompanying consolidated financial statements contain the accounts of American Ammunition, Inc. and its wholly-owned subsidiaries, F&F Equipment, Inc. and Industrial Plating Enterprise Co. All significant intercompany transactions have been eliminated. The consolidated entities are collectively referred to as "Company".

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### Note C - Going Concern Uncertainty

The Company continues to experience fluctuating periodic revenues, as demonstrated in Note P. The Company's operations consistently demonstrate a negative cash flow position as evidenced by net cash used in operating activities of approximately \$(1,716,000), \$(1,802,000), \$(649,000), \$(2,918,000), \$(1,236,000) and \$(1,100,000) for each of the respective years ended December 31, 2006, 2005, 2004, 2003, 2002 and 2001.

The Company has sustained liquidity through the sale of equity securities, restricted and unrestricted, domestically and in international markets and significant working capital advances have been made by members of management and/or existing shareholders. Future liquidity may be dependent upon future offerings of debt and/or equity securities; however, the availability of further liquidity from these sources is uncertain.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note C - Going Concern Uncertainty - Continued

The Company's continued existence is principally dependent upon its ability to generate sufficient cash flows from operations to support its daily operations on a timely basis. There is no assurance that the Company will be able to obtain raw materials in sufficient quantity, due to its financial condition, to ensure success of its business plan. Further the ability to obtain additional funding through the sales of additional equity securities or, that such funding, if available, will be obtained on terms favorable to or affordable by the Company is uncertain.

The Company anticipates that additional working capital will be necessary to support and preserve the integrity of the corporate entity. However, there is no assurance that the Company will be able to obtain additional funding through either bank lines-of-credit or the sale of additional equity securities or, that such funding, if available, will be obtained on terms favorable to or affordable by the Company.

If no additional operating capital is received during the next twelve months, the Company will be forced to rely on existing cash in the bank, the cash generated from operating activities and/or additional funds loaned by the Company's management and/or shareholders to preserve the integrity of the corporate entity. In the event, the Company is unable to acquire advances from management and/or significant stockholders, the Company's ongoing operations would be negatively impacted to the point that all operating activities are ceased.

While the Company is of the opinion that good faith estimates of the Company's ability to secure additional capital in the future to reach our goals have been made, there is no guarantee that the Company will receive sufficient funding to sustain operations or implement any future business plan steps.

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### Note D - Summary of Significant Accounting Policies - Continued

#### 1. Cash and cash equivalents

For Statement of Cash Flows purposes, the Company considers all cash on hand and in banks, certificates of deposit and other highly-liquid investments with maturities of three months or less, when purchased, to be cash and cash equivalents.

Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note D - Summary of Significant Accounting Policies

#### 2. Accounts receivable and Revenue Recognition

In the normal course of business, the Company extends unsecured credit to virtually all of its customers which are located throughout the United States. Because of the credit risk involved, management has provided an allowance for doubtful accounts which reflects its opinion of amounts which will eventually become uncollectible. In the event of complete non-performance, the maximum exposure to the Company is the recorded amount of trade accounts receivable shown on the balance sheet at the date of non-performance.

The Company ships all product on an FOB-Plant, "as-is" basis. Accordingly, revenue is recognized by the Company at the point at which an order is shipped at a fixed price, collection is reasonably assured and the Company has no remaining performance obligations related to the sale. The Company sells all products with "no right of return" by the purchaser for any factor other than defects in the product's production.

On rare occasion, the Company may elect to accept product returns from customers on a case-by-case basis to offset unpaid accounts receivable. These situations are a "last case" scenario and are initiated by senior management through negotiations with the respective customer.

#### 3. Inventory

Inventory consists of raw materials, work-in-process and finished goods related to the production and sale of small arms ammunition. Inventory is valued at the lower of cost or market using the first-in, first-out method.

In November 2004, Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("Statement") No. 151, "Inventory Costs - an amendment of Accounting Research Bulletin No. 43, Chapter 4." Statement No. 151 requires that abnormal amounts of costs, including idle facility expense, freight, handling costs and spoilage, should be recognized as current period charges. The provisions of this Statement became effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Statement No. 151 was adopted the Company on

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January 1, 2006. There was no material impact resulting from the adoption of Statement No. 151 on the Company's financial statements.

### 4. Property, plant and equipment

Property and equipment are recorded at historical cost. These costs are depreciated over the estimated useful lives of the individual assets using the straight-line method, generally three to ten years.

Gains and losses from disposition of property and equipment are recognized as incurred and are included in operations.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note D - Summary of Significant Accounting Policies - Continued

### 5. Income Taxes

The Company uses the asset and liability method of accounting for income taxes. At March 31, 2007 and 2006, the deferred tax asset and deferred tax liability accounts, as recorded when material to the financial statements, are entirely the result of temporary differences. Temporary differences represent differences in the recognition of assets and liabilities for tax and financial reporting purposes, primarily accumulated depreciation and amortization, allowance for doubtful accounts and vacation accruals.

As of March 31, 2007 and 2006, the deferred tax asset related to the Company's net operating loss carryforward is fully reserved. In the event that these carryforwards were not fully utilized, they began to expire in 2005.

### 6. Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing the net income (loss) available to common shareholders by the weighted-average number of common shares outstanding during the respective period presented in our accompanying financial statements.

Fully diluted earnings (loss) per share is computed similar to basic income (loss) per share except that the denominator is increased to include the number of common stock equivalents (primarily outstanding options and warrants).

Common stock equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options and warrants, using the treasury stock method, at either the beginning of the respective period presented or the date of issuance, whichever is later, and only if the common stock equivalents are considered dilutive based upon the Company's net income (loss) position at the calculation date.

As of March 31, 2007 and 2006, and subsequent thereto, the Company had no options outstanding. The outstanding warrants, mandatory convertible preferred stock and mandatory convertible debentures are anti-dilutive due to the Company's net operating loss position.

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### 7. Advertising costs

The Company does not conduct any direct response advertising activities. For non-direct response advertising, the Company charges the costs of these efforts to operations at the first time the related advertising is published.

### 8. Pending and/or New Accounting Pronouncements

The Company is of the opinion that any pending accounting pronouncements, either in the adoption phase or not yet required to be adopted, will not have a significant impact on the Company's financial position or results of operations.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

#### Note E - Correction of an Error

On August 22, 2007, our management concluded that the financial statements included in our Forms 10-QSB for June and September 2005, the calendar year 2006 and for the period ending March 31, 2007, and the Forms 10-KSB for the periods ending December 31, 2005 and December 31, 2006, all of which have been previously filed with the Securities and Exchange Commission, need to be restated, due to the failure to include the beneficial conversion feature discount on unsecured convertible indebtedness.

Management discovered such changes needed to be made after consulting with Pollard-Kelley Auditing Services, our independent registered public accounting firm as of June 26, 2007, who have concurred with management as to the reexamination of the above mentioned issues.

The Company has entered into certain notes payable to shareholders and other affiliated parties with embedded conversion features and warrant issues. The appropriate accounting is governed by EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The fair value is determined to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis.

Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

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American Ammunition, Inc. and Subsidiaries  
 Notes to Consolidated Financial Statements - Continued  
 March 31, 2007 and 2006

Note E - Correction of an Error - Continued

The errors discovered by management relate directly to the accounting for and recording various conversion features and warrants as follows:

	Three months ended March 31, 2007	Three months ended March 31, 2006
	-----	-----
Net Loss, as previously restated and reported	\$ (566,565)	\$ (1,108,192)
Effect of the correction of an error (Increase) Decrease in Net Loss by financial statement line item:		
Operating expenses: Interest expense recognized from beneficial conversion discount feature on notes payable to shareholders and other affiliates	(9,581)	(113,084)
	-----	-----
Total effect of changes on Loss from Operations and Net Loss	(9,581)	(113,084)
	-----	-----
Net Loss, as restated	\$ (576,146)	\$ (1,221,276)
	=====	=====
Net loss available to common stockholders, as previously reported	\$ (579,605)	\$ (1,120,242)
Effect of the correction of an error Total effect as shown above	(9,581)	(113,084)
	-----	-----
Net Loss available to common stockholders, as restated	\$ (589,186)	\$ (1,233,326)
	=====	=====
Earnings per share, as previously reported	\$ (0.02)	\$ (0.26)
Total effect of changes	(0.01)	(0.03)
	-----	-----
Earnings per share, as restated	\$ (0.03)	\$ (0.29)
	=====	=====

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In light of the restatements to the financial statements disclosed above, caused, in part, by a failure in the Company's internal control over financing reporting due to the limitations in the Company's accounting resources to identify and react in a timely manner to non-routine, complex and/or transactions originated by other parties on the Company's behalf, as well as gaining an adequate understanding of the disclosure requirements relating to these types of transactions, we feel that the existing controls and procedures were and remain effective. Because of said controls, which resulted in the review, discovery and disclosure by amendment of filings to adequately disclose required information, management also concludes that by requiring supplemental reviews of financing transactions that its existing controls and procedures will be more effective.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note F - Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable and notes payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions.

Interest rate risk is the risk that the Company's earnings are subject to fluctuations in interest rates on either investments or on debt and is fully dependent upon the volatility of these rates. The Company does not use derivative instruments to moderate its exposure to interest rate risk, if any.

Financial risk is the risk that the Company's earnings are subject to fluctuations in interest rates or foreign exchange rates and are fully dependent upon the volatility of these rates. The company does not use derivative instruments to moderate its exposure to financial risk, if any.

### Note G - Inventory

As of March 31, 2007 and 2006, inventory, as valued using the lower-of-cost or market, consisted of the following components:

	March 31, 2007	March 31, 2006
	-----	-----
Raw materials	\$ 427,591	\$ 359,157
Work in process	155,376	58,717
Finished goods	51,172	7,463
	-----	-----
Totals	\$ 634,139	\$ 425,337
	=====	=====

### Note H - Property and Equipment

Property and equipment consist of the following components:

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	March 31, 2007	March 31, 2006	Estimated useful life
Manufacturing equipment	\$ 7,954,501	\$ 8,126,135	3-10 years
Office furniture and fixtures	71,437	69,889	3- 7 years
Leasehold improvements	184,939	190,277	8-20 years
	-----	-----	
	8,240,877	8,386,301	
Accumulated depreciation	(5,617,158)	(5,608,472)	
Impairment of recoverability of carrying value	(2,623,719)	(2,777,829)	
	-----	-----	
Net property and equipment	\$ -	\$ -	
	=====	=====	

Total depreciation expense charged to operations for the three month periods ended March 31, 2007 and 2006, respectively, was approximately \$41,376 and \$31,024.

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company follows the policy of evaluating all property and equipment as of the end of each reporting quarter. Pursuant to the requirements of this accounting standard, management recorded, at December 31, 2005, an impairment for the future recoverability of these assets of approximately \$2,777,829.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

Note I - Loans from Shareholders

	March 31, 2007	March 31, 2006
	-----	-----
Four separate notes payable to three separate stockholders. Interest at 8.0%, payable monthly. Principal due at maturity on December 31, 2008. Shareholder/lender has the option to convert the principal amount into common stock of the Company at the lesser of 66-2/3% of the average closing bid and ask price on the date of conversion or \$0.08 per share, whichever is less. Each note is unsecured.	\$1,075,000	\$ 975,000
	=====	=====

Note J - Federal Excise Taxes Payable

On March 29, 2007, the Company reached a settlement and executed a Payment Agreement with the Department of the Treasury, Bureau of Alcohol, Tobacco and Firearms, related to an audit, which commenced during 2006, of the Company's Federal Excise Taxes obligation. The Department of Treasury, Bureau of Alcohol, Tobacco and Firearms ratified and affirmed this settlement in writing on April 4, 2007. The Payment Agreement calls for the Company to pay an aggregate total of \$300,000, plus interest at the statutory rate starting on March 29, 2007. The

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payment schedule is as follows: April 2007 through March 2008 - \$3,000 per month; April 2008 - March 2009 - \$4,000 per month; and April 2009 - March 2013 - \$5,000 per month.

This obligation was fully accrued in the Company's financial statements as of December 31, 2006.

### Note K - Convertible Debenture

The Company entered into a Securities Purchase Agreement with La Jolla Cove Investors, Inc. ("La Jolla") on October 4, 2002 for the sale of: (i) \$250,000 in convertible debentures; and (ii) warrants to buy 30,000,000 shares of the Company's common stock. On March 13, 2003 and May 6, 2003, La Jolla advanced an aggregate of \$350,000 to the Company, the funds of which were allocated towards the principal balance of our convertible debentures.

As of September 30, 2006, the outstanding balance on the La Jolla convertible debenture has been retired. A recap of the debenture activity is as follows:

	Debenture (in dollars)	Warrant (in shares)
	-----	-----
Initial amount	\$ 600,000	6,000,000
2003 redemptions	(208,635)	(2,086,350)
2004 redemptions	(125,000)	(1,250,000)
2005 redemptions	(40,000)	(400,000)
2006 retirement	(226,365)	(2,263,650)
	-----	-----
Balances outstanding at September 30, 2006	\$ -	-
	=====	=====

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note K - Convertible Debenture - Continued

In addition to retiring the debenture, the Company repaid \$200,000 in prepaid warrant exercises and approximately \$158,635 in negotiated prepayment and penalty fees for an aggregate payment of \$585,000.

Additionally, the Company recognized a charge to operations, including the aforementioned \$158,635 cash payment, of approximately \$354,450 for the issuance of 56,003 shares of common stock to La Jolla and the forgiveness of \$175,000 in monies due from La Jolla for common stock issued on warrant exercises in prior periods.

On September 13, 2006, the Company received from La Terraza Trading and Asset Management Ltd. (the "Investor") \$2,150,000 for the Company's use and benefit, the funds of which were distributed as follows:

1. \$585,000 was paid to La Jolla to acquire for the Investor a full and complete assignment of any and all of La Jolla's right, title and interest in any and all of the Company's indebtedness to La Jolla and specifically including La Jolla's rights under the active SB-2 Registration Statement

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- for the issuance and registration of securities thereunder; the Company's consent to the foregoing subject to the right of the Company to prepay any and all indebtedness thereunder in the Company's common stock, without penalty, at any time before or after default.
2. \$275,000 to be used by the Company to redeem and satisfy in full the Series E Preferred Stock funded by third party investors on or about July 12, 2006, including a prepayment redemption penalty of \$25,000.
  3. \$215,000 payable as fees to Capital Investment Services, Inc. ("CIS") for locating, negotiating and closing the funding.
  4. \$100,000 to repay in full, without interest, an unsecured bridge loan from the Investor to the Company dated and funded on August 25, 2006.
  5. \$275,000 released to the Company for working capital.
  6. The balance of \$700,000, to be retained in escrow and disbursed to the Company for payment in reduction of the assigned La Jolla debenture and required warrant exercised thereunder, until the debenture and warrant obligations are satisfied in full in accordance with the terms of the assigned La Jolla documents.

The financing transaction requires the Company to deposit in escrow with CIS for later delivery a total of 11,470,000 shares of its common stock (to be held as unissued and not outstanding) to guarantee availability of stock as required for the reduction of the debenture and satisfaction of warrant obligations. The Escrow agreement calls for the Escrow Agent to release such shares for delivery in accordance with the terms of the Company's pending SB-2 Registration Statement currently on file with the Securities and Exchange Commission and in accordance with the terms and conditions of the Financing Agreement dated September 2006 entered into between the Company and the the Investor, and only after reasonable notification thereof to the Company prior to delivery of any such certificates. Disbursement and distribution of shares shall only be made in accordance with the terms of the applicable SB-2 registration.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note K - Convertible Debenture - Continued

The Investor and/or the selling stockholder agreed to restrict its ability to convert or exercise its warrants and receive shares of the Company's common stock such that the number of shares held by them and their affiliates after such conversion or exercise does not exceed 4.9% of the then issued and outstanding shares of the Company's common stock. The agreement also calls for an additional 5,000,000 shares of the Company's restricted common stock to be deposited in a separate escrow to be used for any other expenses and compensation to third parties that may be agreed upon between the Investor and the Company for future services to advance the Company's overall business. In addition, the Company granted the Investor 600,000 warrants exercisable at the lesser of \$0.1875 per share or the average closing price per share for the common stock during the twelve (12) month period prior to the date of exercise, such warrants exercisable at any time on or before five (5) years from and after July 24, 2006. All shares required to be escrowed have in fact been deposited in escrow on September 26, 2006, as required.

The Investor provided additional funding in the amount of \$1,000,000 to the

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Company on December 21, 2006 for an additional 5,333,335 shares. The sum of \$100,000 was paid as fees to CIS for locating, negotiating and closing the additional funding. All other terms and conditions of the escrow agreement and related financing agreement, including incorporation of the terms of the SB-2 requirements, remain the same.

### Note L - Derivative Liability arising from Warrants

The Company accounts for debt with embedded conversion features and warrant issues in accordance with EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The Company determines the fair value to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis.

Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note M - Preferred Stock Transactions

Preferred stock consists of the following as of March 31, 2007 and 2006, respectively:

	March 31, 2007		March 31, 2006	
	# shares	value	# shares	value
Series A Cumulative Convertible Preferred Stock	12,000	\$ 60,000	12,000	\$ 60,000
Series B Cumulative Convertible Preferred Stock	36,680	183,400	73,360	366,800
Series C Convertible Preferred Stock	1,905,882	324,000	1,905,882	324,000
Series E 8% Convertible Preferred Stock	50,000	250,000	50,000	250,000
	-----	-----	-----	-----

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2,004,562	\$817,400	2,040,360	\$1,000,800
=====	=====	=====	=====

### Series A Convertible Preferred Stock

In September, October and November 2001, the Company sold an aggregate 222,600 shares of \$5.00 Series A Convertible Preferred Stock (Series A Preferred Stock) for total proceeds of approximately \$1,113,000 through a Private Placement Memorandum. The Series A Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series A Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events. In December 2001, at the request of the holders of the Series A Preferred Stock, the Company and the individual holders modified the holding period for conversion to allow for conversion in December 2001.

In September 2001, the Company's principal stockholder converted approximately \$4,007,327 of unsecured debt and approximately \$3,546,273 of cumulative and unpaid accrued interest into 1,510,710 shares of Series A Preferred Stock.

In September 2001, a creditor of the Company agreed to convert approximately \$10,000 of trade accounts payable into 2,000 shares of Series A Preferred Stock.

In December 2001, concurrent with a modification in the holding period prior to conversion, certain holders of the Series A Preferred Stock orally notified the Company of their intent to exercise the conversion features on 1,749,720 issued and outstanding shares of Series A Preferred Stock into 19,246,920 shares of common stock prior to December 31, 2001. Due to the timing of the requisite documentation, the clerical activities related to this conversion were not completed until February 2002.

### Note M - Preferred Stock Transactions - Continued

#### Series A Convertible Preferred Stock - continued

In conjunction with the Series A Preferred Stock, certain shares were sold after the Company's common stock was approved for trading by the National Association of Securities Dealers on the OTC Bulletin Board in October 2001. The shares of Series A Preferred Stock sold subsequent to this date had an equivalent per share value of common stock below the ending quoted market price of the Company's common stock on their respective issue dates. This difference created a Beneficial Conversion Feature Discount of approximately \$1,207,993. This discount was then amortized over the unexpired time period between the date of issue of the eligible shares and the eligible conversion date, as amended. All of the shares sold subsequent to the initial trading date were converted in

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December 2001 and, accordingly, the approximate \$1,207,993 in Beneficial Conversion Feature Discount was fully amortized to operations.

In December 2002, a holder of 5,000 shares of Series A Preferred Stock exercised his conversion rights and converted these shares of Series A Preferred Stock into 55,000 shares of restricted, unregistered common stock.

In January 2003, three separate holders of 9,000 shares of Series A Preferred Stock exercised their conversion rights and converted these shares of Series A Preferred stock into 99,000 shares of restricted, unregistered common stock.

### Series B Convertible Preferred Stock

In May 2003, the Company sold an aggregate 91,700 shares of \$5.00 Series B Convertible Preferred Stock (Series B Preferred Stock) for total proceeds of approximately \$458,500 through a separate Private Placement Memorandum. The Series B Convertible Preferred Stock provides for cumulative dividends at a rate of 8.0% per year, payable quarterly, in cash or shares of the Company's common stock at the Company's election. Each share of Series B Preferred Stock is convertible into 11 shares of the Company's common stock initially at any time after 6 months of the date of issue and prior to the notice of redemption at the option of the holder, subject to adjustments for customary anti-dilution events.

In September and December 2004, respectively, the Holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 18,340 shares of Series B Preferred Stock for 66,810 post-reverse split shares of restricted, unregistered common stock.

On March 31, June 30, October 23, and December 27, 2006, respectively, the holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 36,680 shares (9,170 shares per conversion) of Series B Preferred Stock for 831,412 shares of restricted, unregistered common stock.

### Series C Convertible Preferred Stock

In November 2004, the Company sold 1,905,882 shares of Series C Convertible Preferred Stock to an existing stockholder and officer of the Company in a private transaction pursuant to Section (4)2 of the Securities Act of 1933 for gross proceeds of approximately \$324,000. No underwriter was used in conjunction with this transaction.

The Series C Convertible Preferred Stock provides for dividends at a rate of 4.0% per annum, to be declared and paid monthly in either cash or stock at the discretion of the Company.

Note M - Preferred Stock Transactions - Continued

Series C Convertible Preferred Stock - continued

Each share of Series C Preferred Stock is convertible at a rate of \$0.18 per share into 1,800,000 shares of the Company's common stock at any time at the

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option of the holder, subject to adjustments for customary anti-dilution events.

### Series E 8% Convertible Preferred Stock

On March 1, 2006, the Company issued a Private Placement Memorandum offering up to 200,000 shares of Series E 8% Convertible Preferred Stock at an offering price of \$5.00 per share on a "best efforts" basis through an unrelated placement agent.

The Series E 8% Convertible Preferred Stock provides for cumulative dividends at the rate of 8% per year, payable quarterly, 50% in cash and 50% in shares or 100% in cash at the Company's election. In the event the Company elects to pay such dividends in shares of the Company's Common Stock, the number of shares to be issued shall be based on the average of the closing prices of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the Company's Common Stock is then traded) for the 10 consecutive trading days preceding the record date for each such dividend, with such record date being the 14th day preceding the end of each calendar quarter.

Each share of Series E Convertible Preferred Stock shall be convertible into shares of the Company's Common Stock at any time after March 1, 2007. The number of shares to be issued on a conversion shall be based on 80% of the average closing price of the Common Stock of the Company; as reported on the NASDAQ OTC Bulletin Board (or such other market on which such stock is traded) for ten (!0) consecutive trading days preceding the date the Company received notice of such conversion. Subject to certain restrictions, the Series E 8% Convertible Preferred Stock shall automatically convert into shares of the Company's Common Stock upon any of the following events: (I) the sale by the Company of all or substantially all of its assets; (ii) the consummation of a merger or a consolidation in which the Company is not the survivor; or (iii) the sale or exchange of all or substantially all of the outstanding shares of the Company's common stock (including by way of merger, consolidation, or other similar action).

In the event of the liquidation, dissolution or winding up of the Company, the holders of Series E Convertible Preferred Stock shall have a liquidation preference over holders of common stock and shares junior to the Series E 8% Convertible Preferred Stock equal to \$5.50 per share. Additionally, the Company shall not impose or allow any additional liens on it's existing fixed assets in excess of \$1,000,000; provided that at such time as total gross proceeds from the offering equal or exceed \$2,000,000, the Company shall satisfy such existing liens on its existing fixed assets and shall not impose or allow any additional liens on its existing fixed assets unless subordinated to the interest of the

Series E 8% Convertible Preferred Stock, with such preference on the fixed assets equal to the fixed asset value, as determined in accordance with the United States Generally Accepted Accounting Principles ("GAAP"), of 150% of the stated value of the aggregate of the outstanding shares of Series E Convertible Preferred Stock except for fixed assets of the Company that were otherwise purchased pursuant to a security interest.

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Note M - Preferred Stock Transactions - Continued

Series E 8% Convertible Preferred Stock - continued

The Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the Company, for cash in the amount of \$5.50 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate, at any time after March 1, 2007, or in the event the closing sale price of the Company's Common Stock, as reported on the NASDAQ Over the Counter Bulletin Board (or such other market on which the Company's Common Stock is then traded), is greater than or equal to \$7.00 after March 1, 2007 for any consecutive five trading days. In addition, the Series E 8% Convertible Preferred Stock shall be redeemable, at the option of the holder, at any time for shares of the Company's Common Stock in accordance with the Conversion Rate. At any time after March 1, 2007, at the option of the holder, the Series E 8% Convertible Preferred Stock shall be redeemable for cash in the amount of \$5.10 per share of Series E Convertible Preferred Stock or for shares of the Company's Common Stock in accordance with the Conversion Rate. After such date, if redemption is for cash, shares will be redeemed at the rate of 1/10 of such aggregate shares per quarterly period for any 10 consecutive quarters commencing after March 1, 2007. Any redemption by either the Company or the holder shall be subject to 15 days written notice.

The Company warrants and agrees that if, at any time within the period commencing on the date of the final closing of the Offering and expiring on the 5th anniversary of the date thereof, the Company should file a registration statement with the SEC under the Securities Act (other than in connection with a merger or other business combination transaction or pursuant to Form S-8), it will give written notice at least 30 calendar days prior to the filing of each such registration statement to the holders of the Series E 8% Convertible Preferred Stock and the holders of the shares of the Common Stock issued upon the conversion or redemption of the shares of Series E Convertible Preferred Stock, or their permitted assigns (Holders) of its intention to do so. If the Holders notify the Company within 30 calendar days after receipt of any such notice of its or their desire to include any such shares of Common Stock issued or issuable upon the conversion or redemption of the Series E 8% Convertible Preferred Stock in such proposed registration statement, the Company shall use its "best efforts" to have any such shares of Common Stock is issued or issuable upon the conversion or redemption of the Series E 8% Convertible Preferred Stock registered under such registration statement.

Notwithstanding the foregoing, the Company shall have the right at any time after it shall have given written notice (irrespective of whether a written request for inclusion of any such securities shall have been made) to elect not to file any such proposed registration statement, or to withdraw the same after the filing but prior to the effective date thereof. If the managing underwriter of an offering to which the above "piggyback registration rights" apply, in good faith and for valid business reasons, objects to such rights, such objection shall preclude such inclusion. All expenses incurred by the Company in registration of the shares of Common Stock issued or issuable upon the conversion or redemption of The Series E 8% Convertible Preferred Stock, including with out limitation all registration and filing fees, listing fees, printing expenses, fees and disbursements of all independent accounts, or counsel for the Company and the expense of any special audits incident to or required by any such registration and the expenses of complying with the securities or blue sky laws of any jurisdiction shall be paid by the Company.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

### Note M - Preferred Stock Transactions - Continued

#### Series E 8% Convertible Preferred Stock - continued

The Company has agreed to pay the Placement Agent a cash commission equal to 10% of the aggregate Purchase Price of the shares of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Fee). The Company shall also pay the Placement Agent reasonable expenses associated with the Offering, which expenses shall not exceed \$50,000 (Expense Allowance). In addition, the Company shall issue to the Placement Agent 500 warrants for each \$50,000 of Series E Convertible Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Warrants), each warrant entitling the holder to purchase 1 share of the Company's Common Stock at an exercise price of \$0.90 per share exercisable at any time for a period of 3 years from date of issuance.

Upon completion of the Maximum Offering, the Company will receive net proceeds of approximately \$900,000.00. The Company intends to use the net proceeds for potential acquisitions, working capital, general corporate purposes and repayment of outstanding debt.

The Company and the Placement Agent shall have discretion to increase the Maximum Offering to \$2,000,000.00, without notice to investors.

Through June 30, 2006, the Company sold 100,000 shares in a two separate transactions under this Private Placement Memorandum and has received the gross sales proceeds of \$500,000 and has paid an aggregate of \$50,000 to the Placement Agent for the 10% fees due on these transactions.

On September 13, 2006, the Company exercised its repurchase rights and retired 50,000 shares of the Series E 8% Convertible Preferred Stock, including a 10% prepayment penalty, for \$275,000 cash.

### Note N - Common Stock Transactions

On January 9, 2006, by written consent in lieu of meeting, a majority of the Company's stockholders approved a recommendation by the Company's Board of Directors to effect a one share for twenty shares reverse stock split of our common stock, par value \$.001 per share, with fractional shares rounded up to the nearest whole share. The reverse split became effective on that date. As a result of the reverse split, the total number of issued and outstanding shares of the Company's common stock decreased from 92,576,839 to 4,629,381 shares, after giving effect to rounding for fractional shares. The effect of this action is reflected in the Company's financial statements as of the first day of the first period presented.

In conjunction with the above discussed reverse stock split, all share references in the following paragraphs reflect the January 9, 2006 reverse split action.

American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

Note N - Common Stock Transactions - Continued

Calendar 2006 Transactions

In February 2006, the Company issued approximately 41,666 shares of unregistered, restricted common stock to Paul Goebel, the Company's Director of Domestic Sales, as an employee bonus. These shares were valued at approximately \$17,500, which approximated the market value of the shares on the transaction date. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In February 2006, the Company issued approximately 226,065 shares of restricted, unregistered common stock, valued at approximately \$18,325, to an existing stockholder as for payment of accrued interest associated with approximately \$875,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately \$70,080 on this transaction.

In May 2006, the Company issued approximately 266,511 shares of restricted, unregistered common stock, valued at approximately \$21,054, to an existing stockholder as for payment of accrued interest associated with approximately \$975,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately \$69,293 on this transaction.

In September 2006, the Company issued approximately 275,229 shares of its Restricted/unregistered common stock, valued at approximately \$22,018, to an existing stockholder, as payment of accrued interest associated with approximately \$975,000 of short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately \$118,348 on this transaction.

American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

Note N - Common Stock Transactions - Continued

Calendar 2006 Transactions - continued

In December 2006, the Company issued approximately 284,168 shares of restricted, unregistered common stock, valued at approximately \$22,733, to an existing stockholder as for payment of accrued interest associated with approximately \$975,000 short-term working capital loans to the Company and reimbursement of direct public relation expenses. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately \$90,934 on this transaction.

On March 31, June 30, October 23, and December 27, 2006, respectively, the holders of the Series B Preferred Stock exercised their conversion rights and exchanged an aggregate 36,680 shares (9,170 shares per conversion) of Series B Preferred Stock for 831,412 shares of restricted, unregistered common stock.

On September 13, 2006, the Company issued 56,003 shares of common stock to La Jolla Cove Investors, Inc. to complete all obligations to La Jolla and assign any and all of La Jolla's right, title and interest in any and all of the Company's indebtedness to La Jolla and specifically including La Jolla's rights under the active SB-2 Registration Statement for the issuance and registration of securities thereunder; the consent of the Company to the foregoing subject to the right of the Company to prepay any and all indebtedness thereunder in the Company's common stock, without penalty, at any time before or after default to La Terraza Trading and Asset Management, Inc.

In July, August and October 2006, in three separate transactions, the Company issued an aggregate 50,135 shares of restricted, unregistered common stock in payment of approximately \$19,177 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarters ended March 31, June 30 and September 30, 2006, respectively. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

On December 27, 2006, effective as of September 13, 2006, the Company and La Terraza agreed that all pertinent conditions had been met and the Company released the aforementioned 11,470,000 shares of common stock issued pursuant to the Company's active Registration Statement on Form SB-2 to La Terraza in exchange for the previous receipt of approximately \$2,150,000 in cash proceeds,

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the use of which has previously be discussed. The Company paid placement fees of approximately \$215,000 in connection with the sale of these securities and the retirement of the La Jolla convertible debentures. As the per share value of this transaction was substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately \$3,704,810 on this transaction.

On December 27, 2006, the Company issued an additional 5,333,335 shares of common stock to La Terraza for gross proceeds of approximately \$1,000,000. The Company paid placement fees of approximately \$100,000 in connection with the sale of these securities. As the per share value of this transaction was

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### American Ammunition, Inc. and Subsidiaries Notes to Consolidated Financial Statements - Continued March 31, 2007 and 2006

#### Note N - Common Stock Transactions - Continued

##### Calendar 2006 Transactions - continued

substantially less than the "fair value" of the Company's common stock, per the closing price of the Company's common stock on the transaction date, the Company recognized "consulting expense related to the issuance of common stock at less than "fair value" in the amount of approximately \$1,136,000 on this transaction.

##### Calendar 2007 Transactions

In January 2007, the Company issued an aggregate 10,470 shares of restricted, unregistered common stock in payment of approximately \$4,874 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarter ended December 31, 2006. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In April 2007, the Company issued approximately 269,934 shares of restricted, unregistered common stock, valued at approximately \$21,595, to an existing stockholder as for payment of accrued interest associated with approximately \$975,000 short-term working capital loans to the Company and reimbursement of various operating expenses paid in cash on behalf of the Company. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

#### Note O - Stock Warrants

In conjunction with the Company's Private Placement Memorandum for the sale of Series E Convertible Preferred Stock, the Company agreed to issue to the Placement Agent warrants to purchase up to 500 shares of the Company's common stock for each \$50,000 of Series E Convertible Agent Preferred Stock sold by the Placement Agent in the Offering (Placement Agent Warrants), each warrant

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entitling the holder to purchase 1 share of the Company's Common Stock at an exercise price of \$0.90 per share exercisable at any time for a period of 3 years from date of issuance.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

Note O - Stock Warrants - Continued

On September 6, 2006, in conjunction with the \$2,150,000 Financing Agreement with La Terraza, the Company issued warrants to purchase 600,000 shares of common stock at the lesser of \$0.1875 per share or the average closing price per share for the Company's common stock over the twelve (12) month period prior to the date of such exercise, with the warrants being exercisable at any time from the issue date through July 24, 2011. The following table presents warrant activity through March 31, 2007:

	Number of Shares	Weighted Average Exercise Price
	-----	-----
Balance at January 1, 2005	2,663,650	\$ 1.00
Issued	-	-
Exercised	(40,000)	\$ 1.00
Expired	-	-
	-----	-----
Balance at December 31, 2005	2,263,650	\$ 1.00
Issued		
Placement agent warrants	1,000	\$ 0.90
La Terraza warrants	600,000	\$ 0.1875
Exercised	-	-
Expired	(2,263,650)	\$ 1.00
	-----	-----
Balance at December 31, 2006	601,000	\$ 0.1887
Issued	-	-
Exercised	-	-
Expired	-	-
	-----	-----
Balance at March 31, 2007	601,000	\$0.1887
	=====	=====

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Note P - Rental Commitments

The Company leases its corporate office and manufacturing facility from its controlling stockholder under a long-term operating lease agreement. The lease requires a monthly payment of approximately \$5,735, including applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on December 1, 2009 and contains a clause that upon expiration, the Company and the controlling shareholder shall renegotiate the annual rental amount.

The Company's subsidiary, IPE, leases it's manufacturing facility from an unrelated third-party under a long-term operating lease agreement. This lease is for a period of five (5) years and requires graduated monthly payments, changing on the lease anniversary date, ranging from approximately \$1,751 to \$1,914, plus the applicable sales taxes. The Company is responsible for all utilities and maintenance expenses. The lease expires on February 28, 2007 and may be renewed for an additional five (5) year term at a rental rate of approximately \$1,971, plus applicable sales taxes for the first renewal year and 3.0% increase on each succeeding anniversary date. Total rent expense under this lease was approximately \$23,057 and 22,176, respectively, for each of the years ended December 31, 2006 and 2005.

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American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

Note P - Rental Commitments - Continued

In May 2004, the Company entered into a long-term lease agreement for a warehouse facility adjacent to the Company's primary office and manufacturing facility. This lease was for a period of two (2) years and required payments of approximately \$6,206 per month for the first 12 months and approximately \$6,393 for the second 12 months, plus applicable sales taxes. The Company was responsible for all utilities and maintenance expenses. This lease expired on May 31, 2006 and the Company has no further responsibility under this lease agreement.

Future minimum rental payments on the above leases are as follows:

Year ended December 31, -----	Amount -----
2007	\$ 72,643
2008	68,815
2009	68,815
Totals	\$ 210,273 =====

For the respective years ended December 31, 2006 and 2005, the Company paid an aggregate of \$125,862 and \$158,947 in rent under these agreements.

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Note Q - Income Taxes

The components of income tax (benefit) expense for the three month periods ended March 31, 2007 and 2006, respectively, are as follows:

	Three months ended March 31, 2007	Three months ended March 31, 2006
	-----	-----
Federal:		
Current	\$ -	\$ -
Deferred	-	-
	-----	-----
	-	-
	-----	-----
State:		
Current	-	-
Deferred	-	-
	-----	-----
	-	-
	-----	-----
Total	\$ -	\$ -
	=====	=====

As of December 31, 2006, the Company has a net operating loss carryforward of approximately \$14,500,000 to offset future taxable income. Subject to current regulations, components of this carryforward began to expire in 2005. The amount and availability of the net operating loss carryforwards may be subject to limitations set forth by the Internal Revenue Code. Factors such as the number of shares ultimately issued within a three year look-back period; whether there is a deemed more than 50 percent change in control; the applicable long-term tax exempt bond rate; continuity of historical business; and subsequent income of the Company all enter into the annual computation of allowable annual utilization of the carryforwards.

American Ammunition, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements - Continued  
March 31, 2007 and 2006

Note Q - Income Taxes - Continued

The Company's income tax expense (benefit) for the three month periods ended March 31, 2007 and 2006, respectively, differed from the statutory federal rate of 34 percent as follows:

	Three months ended March 31, 2007	Three months ended March 31, 2006
	-----	-----
Statutory rate applied to loss before income taxes	\$ (192,600)	\$ (376,800)
Increase (decrease) in income taxes resulting from:		
State income taxes	-	-
Imputed interest on derivative liability from		

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warrants and convertible notes	3,300	38,000
Other, including reserve for deferred tax asset	192,600	376,800
	-----	-----
Income tax expense	\$ -	\$ -
	=====	=====

Temporary differences, consisting primarily of the net operating loss carryforward and statutory differences in the depreciable lives for property and equipment, between the financial statement carrying amounts and tax bases of assets and liabilities give rise to deferred tax assets and liabilities as of December 31, 2006 and 2005, respectively:

	Year ended December 31, 2006	Year ended December 31, 2005
	-----	-----
Deferred tax assets - long-term		
Net operating loss carryforwards	\$ 4,930,000	\$ 4,080,000
Deferred tax liabilities - long-term		
Statutory depreciation differences	(500,000)	(525,000)
	-----	-----
	4,430,000	3,555,000
Less valuation allowance	(4,430,000)	(3,555,000)
	-----	-----
Net Deferred Tax Asset	\$ -	\$ -
	=====	=====

During the years ended December 31, 2006 and 2005, respectively, the valuation allowance increased (decreased) by approximately \$875,000 and \$1,576,000.

Note R - Contingent Liability

The Company and the Miami-Dade County Property Appraiser are in negotiations related to an audit of the Company's Tangible Personal Property assessments for the years ended December 31, 2002, 2003, 2004 and 2005. The Company is cooperating fully with all requests and is aggressively challenging all claims and using all defenses available to it. The ultimate outcome, and impact on the Company's financial statements, is not readily determinable at this time.

ITEM 2 - Management's Discussion and Analysis or Plan of Operation

Caution Regarding Forward-Looking Information

Certain statements contained in this Registration Statement including, without limitation, statements containing the words "believes", "anticipates", "expects" and words of similar import, constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

Such factors include, among others, the following: international, national and local general economic and market conditions: demographic changes; the

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ability of the Company to sustain, manage or forecast its growth; the ability of the Company to successfully make and integrate acquisitions; raw material costs and availability; new product development and introduction; existing government regulations and changes in, or the failure to comply with, government regulations; adverse publicity; competition; the loss of significant customers or suppliers; fluctuations and difficulty in forecasting operating results; changes in business strategy or development plans; business disruptions; the ability to attract and retain qualified personnel; the ability to protect technology; and other factors referenced in this and previous filings.

Given these uncertainties, readers of this Quarterly Report on Form 10-QSB and investors in our equity securities are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

### Restatement issues

The March 31, 2007 and 2006 financial statements have been restated to account for the derivative liability that was incurred in connection with the common stock conversion features and the warrants issued with certain notes payable.

The Company accounts for debt with embedded conversion features and warrant issues in accordance with EITF 98-5: "Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion" and EITF No. 00-27: "Application of issue No 98-5 to certain convertible instruments". Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The Company determines the fair value to be ascribed to the detachable warrants issued with the convertible debentures utilizing the Black-Scholes method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized discount, if any, upon the conversion of the debentures is expensed to financing cost on a pro rata basis.

Debt issues with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; "Accounting for Derivative Instruments and Hedging Activities". The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

### General

American Ammunition, Inc. is a holding company with two operating subsidiaries: F&F Equipment, Inc. and Industrial Plating Enterprise Co.

F&F Equipment, Inc. (F&F) was incorporated on October 4, 1983 under the laws of the State of Florida. F&F was formed to engage principally in the "import, export, retail & wholesale of firearms equipment, ammunition & other devices and for the purpose of transacting any and/or all lawful business." F&F conducts its business operations under the assumed name of "American Ammunition."

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In June 2002, American Ammunition, Inc. formed a wholly owned subsidiary, Industrial Plating Enterprise Co. (IPE), which started production on June 14, 2002. IPE is a fully licensed and approved electrochemical metallization facility with significant capacity for processing our line of projectiles as well as other products and services while employing environmentally sound water conservation and proven waste treatment techniques.

### Results of Operations

Three months ended March 31, 2007 compared with the three months ended March 31, 2006.

During the three months ended March 31, 2007, we experienced aggregate net revenues of approximately \$690,000, as compared to approximately \$710,000 during the first quarter of Calendar 2006. We experienced costs of goods sold of approximately \$917,000 for the three months ended March 31, 2007 as compared to approximately \$1,378,000 for the three months ended March 31, 2006.

We have expanded our product line during the last quarter of 2006 and the first quarter of 2007 as we have identified a market demand for additional rifle cartridges and "cowboy action shooting" calibers. While we continue to experience strong interest and/or demand and are experiencing increasing orders for these products, our current volumes cause production delays in managing our production tooling setups to produce all of the products in our catalog. We believe that our order quantities will increase to a level to allow for more efficient utilization of our production capacities.

The various raw materials that are integral components of our manufacturing processes are currently subject to rapidly increasing pressures caused by foreign demand, limitations on mining/production and commodity market speculation for both our costs and the overall availability of these resources. We are experiencing direct pressure in the marketplace for the brass component of our ammunition manufacture by recent orders for copper placed by the People's Republic of China. We have also experienced periodic limitations or allocations on the availability of lead for projectile manufacture due to increased demand for this commodity and limitations on the opening of new domestic mines for lead due to various Federal and State environmental laws and regulations. In conjunction with the large order for raw copper placed by the Chinese, the marketplace has experienced a substantial increase in futures speculation on this and other comparable commodities in the financial exchanges. Further, we experience competition for raw materials from our competitors that are better funded and have earned priority status among our suppliers.

We are also experiencing the effect of rapidly increasing energy costs, not only in our own plant; but, in the costs of our raw materials and supplies being purchased from other vendors that are forced to pass these costs through to their customers, including us.

All of these discussed factors are causing significant fluctuation in the prices that we must pay for our raw materials that may or may not be able to be passed through to our customers through price increases. Our management is monitoring both the cost side of this equation and the availability of price increases to our customers and to their end-users. The balancing of these events is highly unpredictable and uncertain as we go forward into future periods.

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During 2006 and 2005, we experienced negative trends off of our standard production costs for material and labor due to difficulties in training new employees, adding new products to our catalog and lower than expected orders due to uncontrollable delays in ordering by various U. S. Governmental entities. Management is of the opinion that the production labor force is stable and able to maintain a constant standard of quality for future periods. We experience variable costs in the area of material consumption and direct labor. We have recognized depreciation expense on production equipment of approximately \$41,300 and \$31,000, respectively, in the above cost of goods expense totals. These depreciation levels are anticipated to fluctuate nominally in future periods based upon either the full depreciation of older equipment and/or the addition of new equipment to expand capacity. In the second quarter of 2006, management took drastic steps to reduce excess labor capacity through the elimination of the 2nd shift, which was never able to reach full utilization. This action is not expected to have any adverse impact on our ability to meet our existing and future product demands.

For the three months ended March 31, 2007 and 2006, respectively, we generated a negative gross profit of approximately \$(227,000) or (32.84%), and approximately \$(668,000) or (94.06%). While we have a backlog of orders and future order commitments from retail customers, distributors and/or governmental agencies, we anticipate that we should be able to generate a positive gross profit in future periods; however, there are no guarantees or any certainty that this will occur.

We experienced nominal research and development expenses of approximately \$600 and \$-0-, during each of the three month periods ended March 31, 2007 and 2006, principally related to research related to the potential expansion of our product line.

In 2004, the Company initiated a direct solicitation program for a "dealer direct" sales program. This endeavor has received a very positive response from the qualified retail resellers of our products. However, we are realizing that the existence of previously announced contracts with various U. S. Governmental agencies and orders from foreign governments are becoming more erratic in their order placements. Accordingly, management is realizing that a consistent demand from the U. S. retail segment will be our best source of consistent sales. Further, we have identified certain production issues which has inhibited the full realization of existing product demands and management believes that the necessary steps are being taken to remedy any production deficiencies.

During the first quarters of 2007 and 2006, we expended approximately \$32,400 and \$56,000, respectively, in advertising and marketing expenses, principally in continuing the promotion and expansion of our retail dealer direct program. We anticipate to continue our marketing efforts in this area in future periods; however, the volume and frequency of our expenditures may fluctuate as management allocates available capital to these efforts. Other general and administrative expenses increased nominally from approximately \$275,000 for the three months ended March 31, 2007 as compared to approximately \$375,000 for the three months ended March 31, 2006. Management is of the opinion that these costs are relatively stable and should not experience significant increases except for inflationary pressures caused principally by increases in energy costs which are affecting all businesses in all sectors of the U. S. economy.

We recognized a net loss of approximately \$(576,000) and \$(946,000) for the respective three month periods ended March 31, 2007 and 2006, respectively, or \$(0.03) and \$(0.29) per share. We wish to note that the loss per share includes the effect of our 1 for 20 reverse stock split on January 9, 2006.

### Liquidity And Capital Resources

As of March 31, 2007, December 31, 2006 and March 31, 2006, respectively, we had working capital of approximately \$296,000, \$684,000 and \$(1,604,000). Our working capital position continues to fluctuate based on collections on our trade accounts receivable. We anticipate that we have sufficient inventory levels to support our order demand and have access to raw material suppliers that will enable us to receive raw materials for future periods. We also note that at the end of 2006, we renegotiated \$1,075,000 in notes payable to existing shareholders to long-term status with renewed maturity dates of December 31, 2008. Due to this relationship, these notes may or may not be renegotiated, repaid in common stock of the Company or otherwise reclassified prior to their maturity on December 31, 2008.

We have used cash in operating activities of approximately \$(467,000) and \$(385,000) during each of the quarters ended March 31, 2007 and 2006, respectively. Due to our history of operating losses, our resources for additional working capital are becoming more scarce.

We anticipate that our liquidity position will continue to improve as management is of the opinion that, with the current changes to our production capacity, the Company will be in a position to better support all existing orders and accept existing and future inquiries.

During the quarters ended March 31, 2007 and 2006, respectively, we added approximately \$41,000 and \$31,000 in new equipment. Any equipment to be added in future periods is fully dependent upon the Company's cash position, the availability of either new equity or debt capital and the ultimate realization of communicated future product sales demand. However, we may not be able to obtain additional funding or, that such funding, if available, will be obtained on terms favorable to or affordable by us.

### ITEM 3 - Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act), for the quarter ended March 31, 2007. As of the end of the period covered by this report, management, including the chief executive officer and chief financial officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based upon and as of the date of that evaluation, our CEO and CFO concluded that the disclosure controls and procedures were effective

#### (b) Changes in Internal Controls

There were no significant changes (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal controls over financial reporting that occurred during the quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

## ITEM 1 - Legal Proceedings

From time to time the Company may become subject to various legal proceedings that are incidental to the ordinary conduct of its business. The Company does not consider any such proceedings to date, either individually or in the aggregate, to be material to its business or likely to result in a material adverse effect on its future operating results, financial condition, or cash flows.

## ITEM 2 - Unregistered Sales of Equity Securities and Use of Proceeds

In January 2007, the Company issued an aggregate 10,470 shares of restricted, unregistered common stock in payment of approximately \$4,874 in accrued dividends payable on the Company's outstanding Series B Preferred Stock for the quarter ended December 31, 2006. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

In April 2007, the Company issued approximately 269,934 shares of restricted, unregistered common stock, valued at approximately \$21,595, to an existing stockholder as for payment of accrued interest associated with approximately \$975,000 short-term working capital loans to the Company and reimbursement of various operating expenses paid in cash on behalf of the Company. The Company relied upon Section 4(2) of the Securities Act of 1933, as amended, for an exemption from registration of these shares and no underwriter was used in this transaction.

## ITEM 3 - Defaults on Senior Securities

None

## ITEM 4 - Submission of Matters to a Vote of Security Holders

None

## ITEM 5 - Other Information

None

## ITEM 6 - Exhibits and Reports on Form 8-K

(a) The following sets forth those exhibits filed pursuant to Item 601 of Regulation S-K:

Exhibit	Descriptions
-----	-----
31.1	Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
32.1	Certification pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

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(b) The following sets forth the Company's reports on Form 8-K that have been filed during the quarter for which this report is filed:

None.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

American Ammunition, Inc.

Dated: October 19, 2007  
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/s/ Andres F. Fernandez  
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Andres F. Fernandez  
President, Chief Executive Officer  
Chief Financial Officer and Director

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