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

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: **June 30, 2024**

☐ 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. **001-40222**

Airship AI Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**93-4974766**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
8210 154th Ave NE, Redmond,	**98052**
(Address of principal executive offices)	(Zip Code)

(877) 462-4250
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	AISP	The Nasdaq Stock Market LLC
Warrant	AISPW	The Nasdaq Stock Market LLC

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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☒
		Emerging growth company	☒

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes☐ No ☒

As of August 14, 2024, there were a total of23,736,027 shares of the registrant's common stock issued and outstanding.

Airship AI Holdings, Inc.

Quarterly Report on Form 10-Q
Quarterly Period Ended June 30, 2024

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PART I

ITEM 1. FINANCIAL STATEMENTS.

AIRSHIP AI HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
As of June 30, 2024 and December 31, 2023

	June 30, 2024 (Unaudited)	12/31/2023 (1)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 226,750	$ 3,124,413
Accounts receivable, net of provision for credit losses of $0	3,440,121	1,648,904
Prepaid expenses and other	494,616	18,368
Income tax receivable	9,640	7,230
Total current assets	4,171,127	4,798,915
PROPERTY AND EQUIPMENT, NET	-	1,861
OTHER ASSETS		
Other assets	180,432	182,333
Operating lease right of use asset	953,713	1,104,804
TOTAL ASSETS	$ 5,305,272	$ 6,087,913
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Accounts payable - trade	$ 1,505,442	$ 2,908,472
Advances from founders	2,550,000	1,750,000
Accrued expenses	161,406	200,531
Senior Secured Convertible Promissory Notes	2,675,919	2,825,366
Current portion of operating lease liability	198,002	174,876
Deferred revenue- current portion	3,791,970	4,008,654
Total current liabilities	10,882,739	11,867,899
NON-CURRENT LIABILITIES:		
Operating lease liability, net of current portion	795,993	943,702
Warrant liability	5,972,729	667,985
Earnout liability	11,741,351	5,133,428
Deferred revenue- non-current	3,878,997	4,962,126
Total liabilities	33,271,809	23,575,140
COMMITMENTS AND CONTINGENCIES (Note 9)		
STOCKHOLDERS' DEFICIT:		
Preferred stock - no par value,5,000,000 shares authorized, 0 shares issued and outstanding as of June 30, 2024 and December 31, 2023	-	-
Common stock - $0.0001 par value, 200,000,000 shares authorized, 23,736,027 and 22,812,048 shares issued and outstanding as of June 30, 2024 and December 31, 2023	2,372	2,281
Additional paid in capital	3,014,089	-
Accumulated deficit	(30,979,174)	(17,476,700)
Accumulated other comprehensive loss	(3,824)	(12,808)
Total stockholders' deficit	(27,966,537)	(17,487,227)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 5,305,272	$ 6,087,913

(1) Derived from the audited consolidated balance sheet.

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

AIRSHIP AI HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS)
For the three and six months ended June 30, 2024 and 2023

(Unaudited)

	Three Months Ended June 30, 2024	Three Months Ended June 30, 2023	Six Months Ended June 30, 2024	Six Months Ended June 30, 2023
NET REVENUES:				
Product	$ 5,358,808	$ 1,805,163	$ 14,757,584	$ 3,639,329
Post contract support	1,042,223	964,855	2,218,462	2,069,286
	6,401,031	2,770,018	16,976,046	5,708,615
COST OF NET REVENUES:				
Cost of Sales	1,306,386	557,792	9,095,795	2,135,958
Post contract support	588,438	538,889	745,917	1,095,040
	1,894,824	1,096,681	9,841,712	3,230,999
GROSS PROFIT	4,506,207	1,673,337	7,134,334	2,477,616
RESEARCH AND DEVELOPMENT EXPENSES	702,771	665,203	1,398,137	1,339,283
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	2,827,120	4,092,646	6,162,414	5,925,016
TOTAL OPERATING EXPENSES	3,529,891	4,757,849	7,560,551	7,264,299
OPERATING INCOME (LOSS)	976,316	(3,084,512)	(426,217)	(4,786,683)
OTHER INCOME (EXPENSE):				
Gain (loss) from change in fair value of earnout liability	14,876,927	-	(6,607,923)	-
Gain (loss) from change in fair value of warrant liability	1,542,347	-	(5,304,744)	-
Gain (loss) from change in fair value of convertible debt	1,527,193	-	(512,184)	-
Loss on note conversion	-	-	(158,794)	-
Interest expense, net	(421,500)	(19,005)	(453,324)	(19,005)
Other (expense) income	(39,288)	238	(39,288)	(9,767)
Total other income (expense), net	17,485,679	(18,767)	(13,076,257)	(28,772)
INCOME (LOSS) BEFORE PROVISON FOR INCOME TAXES	18,461,995	(3,103,279)	(13,502,474)	(4,815,455)
Provision for income taxes	-	-	-	-
NET INCOME (LOSS)	18,461,995	(3,103,279)	(13,502,474)	(4,815,455)
OTHER COMPREHENSIVE INCOME				
Foreign currency translation income, net	3,239	-	8,984	42,551
TOTAL COMPREHENSIVE INCOME (LOSS)	$ 18,465,234	$ (3,103,279)	$ (13,493,490)	$ (4,772,904)
NET INCOME (LOSS) PER SHARE:				
Basic	$ 0.80	$ (0.14)	$ (0.59)	$ (0.21)
Diluted	$ 0.58	$ (0.14)	$ (0.59)	$ (0.21)
Weighted average shares of common stock outstanding				
Basic	23,220,709	22,812,048	23,059,598	22,812,048
Diluted	30,272,228	22,812,048	23,059,598	22,812,048

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

AIRSHIP AI HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIT
For the six months ended June 30, 2024 and 2023

(Unaudited)

	Common Stock	Common Stock $	Additional Paid in Capital	Accumulated Deficit	Other Comprehensive Income (Loss)	Total Stockholders' Deficit
Balance as of January 1, 2023	22,812,048	$ 2,281	$ 1,963,727	$ (10,314,313)	$ (10,106)	$ (8,358,411)
Stock-based compensation	-	-	136,709	-	-	136,709
Net loss	-	-	-	(1,712,176)	-	(1,712,176)
Balance as of March 31, 2023	22,812,048	2,281	2,100,436	(12,026,489)	(10,106)	(9,933,878)
Stock-based compensation- stock option grants	-	-	136,709	-	-	136,709
Stock based compensation- warrants	-	-	2,136,115	-	-	2,136,115
Foreign currency translation gain	-	-	-	-	42,551	42,551
Net loss	-	-	-	(3,103,279)	-	(3,103,279)
Balance as of June 30, 2023	22,812,048	2,281	4,373,260	(15,129,768)	32,445	(10,721,782)
Balance as of January 1, 2024	22,812,048	2,281	-	(17,476,700)	(12,808)	(17,487,227)
Stock-based compensation	-	-	268,989	-	-	268,989
Issuance of common stock for prior period services	15,000	-	-	-	-	-
Issuance of common stock for conversion of debt	169,204	17	835,593	-	-	835,610
Issuance of common stock for exercise of warrants	162,867	16	293,233	-	-	293,249
Foreign currency translation gain	-	-	-	-	3,239	3,239
Net loss	-	-	-	(31,964,469)	-	(31,964,469)
Balance as of March 31, 2024	23,159,119	2,314	1,397,815	(49,441,169)	(9,569)	(48,050,609)
Stock-based compensation	-	-	261,636	-	-	261,636
Issuance of common stock for services	50,000	5	198,495	-	-	198,500
Issuance of common stock for exercise of warrants	100	-	800	-	-	800
Issuance of common stock for stock options exercise	294,448	29	146,943	-	-	146,972
Issuance of common stock for debt interest payment	232,360	23	1,008,400	-	-	1,008,423
Foreign currency translation gain	-	-	-	-	5,745	5,745
Net income	-	-	-	18,461,995	-	18,461,995
Balance as of June 30, 2024	23,736,027	$ 2,372	$ 3,014,089	$ (30,979,174)	$ (3,824)	$ (27,966,537)

The shares of the Company's common stock, prior to the Merger, have been retroactively restated as shares reflecting the exchange ratio of approximately 1.7581 established in the Merger described in Note 1.

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

AIRSHIP AI HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended June 30, 2024 and 2023

(Unaudited)

		Six Months Ended June 30, 2024		Six Months Ended June 30, 2023
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$	(13,502,474)	$	(4,815,455)
Adjustments to reconcile net loss to net cash used in operating activities				
Depreciation and amortization		1,861		7,440
Stock-based compensation- stock option grants		530,625		273,418
Stock-based compensation- warrants		-		2,136,115
Amortization of operating lease right of use asset		151,091		358,199
Issuance of common stock for services		198,500		
Noncash interest expense		521,582		
Loss from change in fair value of warrant liability		5,304,744		-
Loss from change in fair value of earnout liability		6,607,923		-
Loss from change in fair value of convertible note		512,184		-
Loss on note conversions		158,794		-
Changes in operating assets and liabilities:				
Accounts receivable		(1,791,217)		40,554
Prepaid expenses and other		11,394		(159)
Other assets		1,901		-
Operating lease liability		(124,583)		(302,233)
Payroll and income tax receivable		(2,410)		962,793
Accounts payable - trade and accrued expenses		(1,426,970)		(66,397)
Accrued income tax expense		-		(10,000)
Deferred revenue		(1,299,813)		678,623
NET CASH USED IN OPERATING ACTIVITIES		(4,146,868)		(737,102)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from convertible promissory note		-		1,984,582
Proceeds from warrant exercise		293,249		-
Advances from founders, net		800,000		1,100,000
Proceeds from stock option exercises		146,972		-
Repayment of small business loan and line of credit		-		(424,540)
NET CASH PROVIDED BY FINANCING ACTIVITIES		1,240,221		2,660,042
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(2,906,647)		1,922,940
Effect from exchange rate on cash		8,984		41,306
CASH AND CASH EQUIVALENTS, beginning of period		3,124,413		298,614
CASH AND CASH EQUIVALENTS, end of period	$	226,750	$	2,262,860
Supplemental disclosures of cash flow information:				
Interest paid	$	-	$	5,064
Taxes paid	$	2,410	$	14,837
Noncash investing and financing				
Elimination of advances to founders in connection with contribution of Zeppelin by shareholders	$	-	$	1,100,000
Elimination of payables to founders in connection with contribution of Zeppelin by shareholders	$	-	$	1,100,000
Issuance of common stock for debt interest payment		487,642		
Issuance of common stock for debt conversion	$	835,610	$	-
Recognition of warrant liability	$	-	$	15,418

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

AIRSHIP AI HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization

On March 7, 2023, Airship AI Holdings, Inc. changed its name from Super Simple AI, Inc. Airship AI Holdings, Inc. (the "Company" or "Airship") is a holding company that executes business through its wholly owned subsidiary, Airship AI, Inc. ("Airship AI"). Prior to the formation of Super Simple AI, Inc. in 2022, the Company operated as Airship AI, Inc. (formerly known as JDL Digital Systems, Inc.). Super Simple AI, Inc. was formed in January 2022 through a share exchange with JDL Digital Systems, Inc. JDL Digital Systems, Inc. was incorporated under the laws of the State of Washington on June 30, 2003.

On December 21, 2023, the Company completed the merger contemplated by the Merger Agreement, dated as of June 27, 2023 and amended on September 22, 2023, by and among BYTE Acquisition Corp. ("BYTS"), BYTE Merger Sub, Inc., a Washington corporation and a direct, wholly-owned subsidiary of BYTS ("Merger Sub"), and Airship AI.

Effective December 21, 2023, Merger Sub merged with and into Airship AI with Airship AI as the surviving corporation. Thus, Airship AI became a wholly-owned subsidiary of the Company. In connection with the merger, Airship AI changed its name to "Airship AI, Inc." See Note 13 —Reverse Recapitalization for additional information.

Fair Value Transactions

As a result of the merger, the Company entered into the following transactions that were measured at fair value and vary quarterly with the share price and other items. Any change is non-cash and is recorded as a gain or loss in other income (expense). See Note 14– Fair Value Measurements for more information.

	Liability as of June 30, 2024	Liability as of December 31, 2023
Earnout liability	$ 11,741,351	$ 5,133,428
Senior Secured Convertible Promissory Notes	2,675,919	2,825,366
Warrant liability (Public Warrants)	144,120	646,428
Warrant liability (Private Warrants)	5,828,609	21,557
Total liabilities measured at fair value	$ 20,389,999	$ 8,626,779
Other loss related to instruments recorded at fair value during the six months ended June 30, 2024	$ (12,424,851)	
Other loss related to instruments recorded at fair value during the six months ended June 30, 2023	$ -	

Private Placement and Public Warrants

At the merger closing, the Company assumed 515,000 private placement warrants and 16,184,612 public warrants. On June 3, 2024, the Company permanently reduced the exercise price of such warrants from $11.50 per share to an exercise price of $7.80 per share. The purpose of this reduced exercise price was to potentially raise proceeds received from the exercise of such warrants, if any, for working capital and general corporate purposes. As of June 30, 2024, there were 515,000 private placement warrants and 16,159,012 public warrants outstanding. See Note 12– Private Placement and Public Warrants for more information.

Business

The Company is a robust AI-driven data management platform that solves complex data challenges for large institutions operating in dynamic and mission-critical environments with rapidly increasing volumes of data being ingested from a similarly rapidly growing number of data sources.

The Company solves these challenges by structuring “dark” or unstructured data at the edge, the location at which the data is generated and collected, and leveraging purpose-built AI models. Unstructured, or “dark” data, which is typically categorized as qualitative data, cannot be processed and analyzed via conventional data tools and methods. Conversely, structured data, typically categorized as quantitative data, is highly organized and easily decipherable by machine learning algorithms.

Structuring and then analyzing data using AI models at the edge, versus transmitting the data from the edge back to a central processing location for structuring and analysis, enables real-time decision making and data-driven operational efficiency.

The Company specializes in ingesting all available metadata from edge-based sensors used by government and law enforcement agencies around the world, including surveillance cameras (video), audio, telemetry, acoustic, seismic, and autonomous devices, along with large commercial corporations with fundamentally similar capabilities and requirements.

Data generated by these edge-based sensors, including video, can then be run through the Company’s trained AI models to detect objects present within the video frame. Once an object is detected, for example an automobile, additional identifying characteristics of the object can be extracted from the image including the license plate characters and the make, model, and color of the automobile. This process of analyzing, logging and categorizing ingested data is referred to as “structuring” the data.

Airship AI’s software allows customers to view structured data both in real-time as well as to conduct searches on the structured data at a later point in time. Real-time structured data use includes, for example, alarms on a specific license plate or a specific make, model or color of automobile. Non-real-time structured data use includes, for example, searching a database of video data that has been previously ingested and stored to find instances of a particular license plate being visible, along with other logged vehicle characteristics such as make, model and color of an automobile.

Additional edge deployed AI models enable similar object detection and recognition of common and custom trained objects, such as an aircraft, boat, person, animal, bag, or weapon. Airship AI’s models provide similar data points for these object types allowing analysts the ability to be notified in real-time of the detection of a specified object and similarly search for historically detected objects. Examples include detecting aircrafts and boats along with their respective tail numbers and hull registration numbers.

The Company’s AI modelling process starts with pre-trained AI models from its technology ecosystem partners which the Company then customizes using proprietary datasets tailored towards its customers’ unique workflow requirements. Where customers have pre-existing AI models or engines, the Company integrates those models or engines into its edge platform allowing customers to leverage proprietary models within the Airship AI software ecosystem.

The Company’s primary offerings include Outpost AI, Acropolis, and Airship Command. Its offerings allow customers to manage their data across the full data lifecycle, when and where they need it, using a highly secure permissioned based architecture.

The Company employed 51 employees as of June 30, 2024. The employees are headquartered in Redmond, WA and are supported by a growing team at its Customer Center of Excellence located in Charlotte, NC. The Company employed 8 research and development personnel in Taiwan as of June 30, 2024.

Liquidity

The Company has incurred losses from operations the past few years and had an accumulated deficit of $30,979,174 as of June 30, 2024. The Company also had at June 30, 2024 a working capital deficit of approximately $6,712,000. The net working capital deficit included a couple of items that are expected to require limited cash outlays in the future, including the current deferred revenue totaling $3,791,970 and convertible debt totaling $2,675,919, which the Company expects to be converted to equity.

The Company has received purchase orders from various federal government agency customers totaling over $16 million from which it started shipping in the first and second quarters of 2024.

Mr. Huang, the Company’s CEO, has committed to providing additional temporary funding if it is necessary.

Based on the Company’s actions undertaken during 2023 and 2024 to close customer deals, build sales pipeline, manage operating expenses and opportunities to raise additional capital after the merger, management believes that the Company’s current cash and cash equivalents will be sufficient to fund its operations for at least the next 12 months from the issuance of these consolidated financial statements.

The Company's assessment of the period of time through which its financial resources will be adequate to support its operations is a forward-looking statement and involves risks and uncertainties. The Company's actual results could vary as a result of its near and long-term future capital requirements that will depend on many factors.

2. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements were prepared in conformity with U.S. generally accepted accounting principles ("GAAP").

For periods prior to the merger, the reported share and per share amounts have been retroactively converted by the applicable exchange ratio with the exception of the authorized shares and shares reserved for issuance. See Note 11—Reverse Recapitalization for additional information.

Functional Currency

The Company's consolidated functional currency is the U.S. Dollar. The operations of Zeppelin Worldwide, Inc. and its subsidiary, Zeppelin Taiwan, Ltd. (together "Zeppelin") use the Taiwan Dollar as its functional currency. At each period end, Zeppelin's balance sheet is translated into U.S. Dollars based upon the period end exchange rate, while their statements of operations and comprehensive loss and statements of cash flows are translated into U.S. Dollars based upon an average exchange rate during the period.

Cash and Cash Equivalents

The Company classifies highly liquid temporary investments with an original maturity of three months or less when purchased as cash equivalents. The Company maintains cash balances at various financial institutions. Balances at US banks are insured by the Federal Deposit Insurance Corporation up to $250,000. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risk for cash on deposit.

Revenue Recognition and Deferred Revenue

The Company primarily generates revenue from sales of systems and products and the related post contract support to customers. The Company's primary systems and products include Outpost AI, Acropolis and Airship Command. To date, the majority of the Company's product revenue that has been recognized consists primarily of a bundled offering of hardware and software which delivers on premise solutions to its customers. Separate limited software subscription services have been delivered to customers including those customers that are able to operate in a cloud based environment. The transaction price recognized as revenue represents the amount the Company expects to be entitled to and is primarily comprised of product revenue, net of returns and variable consideration, including sales incentives provided to customers. Payment is typically due within 30 to 90 calendar days of the invoice date.

The Company recognizes revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services by following a five-step process: (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price, and (5) recognize revenue when or as the Company satisfies a performance obligation, as further described below.

Product Revenue

Product revenue is derived primarily from sales of the Company's system offerings, Outpost AI, Acropolis and Airship Command. The Company recognizes product revenue at a point in time when title transfers, when the products are shipped, or when control of the system is transferred to the customer, which usually is upon delivery of the system and when contractual performance obligations have been satisfied.

Post Contract Support Revenue

Post Contract Support ("PCS") revenue is derived primarily from the Company's support and software maintenance agreements ("SMA"). The Company's PCS includes the right to receive, on a when and if available basis, future unspecified firmware upgrades and features as well as bug fixes, and email and telephone support. The Company allocates a portion of the transaction price to the PCS performance obligation based on a cost-plus methodology and recognizes the associated revenue on a straight-line basis over the estimated term of the support period. The Company's support contracts are typically one to five years with an average of four years, payment is due within 30 to 90 calendars days of the invoice date and may include options to renew. For the three months ended June 30, 2024 and 2023, the Company recognized revenue of $80,236 and $40,608, respectively, related to one-year support contracts. For the three months ended June 30, 2024 and 2023, the Company recognized revenue of $961,987 and $924,247, respectively, related to multi-year support contracts. For the six months ended June 30, 2024 and 2023, the Company recognized revenue of $139,597 and $81,215, respectively, related to one-year support contracts. For the six months ended June 30, 2024 and 2023, the Company recognized revenue of $2,078,865 and $1,988,071, respectively, related to multi-year support contracts.

Other Services

The Company earns other service revenues from installation services, training and licensing which are short-term in nature and revenue for these services are recognized at the time of performance when the service is provided.

Contracts with Multiple Performance Obligations

The Company's contracts with customers often contain multiple performance obligations that can include three separate obligations: (i) a hardware component (which may be bundled with hardware accessories) and the embedded firmware essential to the functionality of the hardware component delivered at the time of sale; (ii) the right to the Company's downloadable free application and software solutions, and (iii) the right for the customer to receive post contract support ("PCS") after the initial sale. The Company's products and PCS offerings have significant standalone functionalities and capabilities. Accordingly, the products are distinct from the Company's PCS services as customers can benefit from the products without the PCS services and such PCS services are separately identifiable within the contracts. The Company accounts for multiple agreements with a single customer as a single contract if the contractual terms and/or substance of those agreements indicate that they may be so closely related that they are, in effect, parts of a single contract. The amount of consideration the Company expects to receive in exchange for delivering on the contract is allocated to each performance obligation based on its relative standalone selling price.

The Company establishes the standalone selling price using the prices charged for a deliverable when sold separately. If the standalone selling price is not observable through past transactions, the Company estimates the standalone selling price based on its pricing model and offering type (products or PCS services).

The Company has elected the practical expedient to not assess whether a contract has a significant financing component as the Company's standard payment terms are less than one year.

The Company sells its products primarily through a direct sales force. The Company considers revenue to be earned when all of the following criteria are met:

- The Company has a contract with a customer that creates enforceable rights and obligations,
- Promised performance obligations are identified,
- The transaction price, or the amount the Company expects to receive, is determinable and
- The Company has satisfied the performance obligations to the customer.

Transfer of control is evidenced upon passage of title and risk of loss to the customer unless the Company is required to provide additional services.

The Company's short-term and long-term deferred revenue balances totaled $3,791,970 and $3,878,997 as of June 30, 2024. The Company's short-term and long-term deferred revenue balances totaled $4,008,654 and $4,962,126 as of December 31, 2023. Of the deferred revenue balance of $8,970,780 as of January 1, 2024, the Company recognized approximately $1,000,090 and $2,166,588 during the three and six months ended June 30, 2024, respectively.

Accounts Receivable and Provision for Credit Losses

The Company generally sells its products to large governmental entities and large corporations in the United States. Accounts receivable are recorded at invoiced amounts and are non-interest bearing.

The Company adopted Accounting Standards Update ("ASU") No. 2016-13, Financial Instruments — Credit Losses (codified as Accounting Standards Codification ("ASC") 326) on January 1, 2023. ASC 326 adds to U.S. GAAP the current expected credit loss ("CECL") model, a measurement model based on expected losses rather than incurred losses. Prior to the adoption of ASC 326, the Company evaluated receivables regularly and adjusted the allowance for doubtful accounts accordingly. The Company determined estimates of uncollectible accounts receivable based primarily on actual historical bad debt and sales return trends, customers financial condition and general economic conditions. Under the application of ASC 326, the Company's historical credit loss experience provides the basis for the estimation of expected credit losses, as well as current economic and business conditions, and anticipated future economic events that may impact collectability. In developing its expected credit loss estimate, the Company evaluated the appropriate grouping of financial assets based upon its evaluation of risk characteristics, including consideration of the types of products and services sold. Account balances are written off against the allowance for expected credit losses after all means of collection have been exhausted and the potential for recovery is considered remote.

Occasionally certain long-standing customers, who routinely place large orders, will have unusually large receivables balances relative to the total gross receivables. Management monitors the payments for these large balances closely and very often requires payment of existing invoices before shipping new sales orders. As of June 30, 2024 and December 31, 2023, the Company did not have a reserve for credit losses as all accounts receivable are considered collectible. Accounts receivable balances as of June 30, 2024 and December 31, 2023 were $3,440,121 and $1,648,904, respectively.

Concentration of Credit and Sales Risk

The Company sells its product to commercial and government customers under agreements that are normally paid within 30 days of contract completion.

For the six months ended June 30, 2024, the Company had revenue from 36 customers and two customer represented72% and 11% of total revenue, although such a high level of customer concentration is not typical. The primary reason for the high level of customer concentration for the six months ended June 30, 2024 was due to one large order received in late 2023 which was fulfilled in the six months ended June 30, 2024. As of June 30, 2024, four customers represent approximately 49%, 20%, 11% and 10% of outstanding account receivables. Due to the nature of the customers and timely payment history, customer concentration and credit risk in account receivables is estimated to be minimal.

For the six months ended June 30, 2023, two customers represented60% and 18% of total revenue. The primary reason for the high level of customer concentration for the six months ended June 30, 2023 was due to the lag-time in delivering on a large order received in late 2022 from one division of a customer which was not fulfilled until 2023. As of December 31, 2023, three customers represent approximately 51%, 26% and 17% of outstanding account receivables. Due to the nature of the customers and timely payment history, customer concentration and credit risk in account receivables is estimated to be minimal.

Inventory

The Company's purchase of inventory, primarily computer servers, is undertaken to match purchase orders received from customers. Upon receipt of inventory, the Company generally configures the servers and loads proprietary software onto the servers before shipping out. The Company holds inventory for a short period of time and as of June 30, 2024 and December 31, 2023, it had no inventory in stock. Inventory value is primarily material costs and is valued at the lower of cost (first in, first out method) or net realizable value.

Long-Lived Assets

The Company reviews its long-lived assets for impairment annually or when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets under certain circumstances are reported at the lower of carrying amount or fair value. Assets to be disposed of and assets not expected to provide any future service potential to the Company are recorded at the lower of carrying amount or fair value (less the projected cost associated with selling the asset). To the extent carrying values exceed fair values, an impairment loss is recognized in operating results. The Company recorded impairment losses of $0 for the six months ended June 30, 2024 and 2023.

Research and Development Expenses

Research and development expenses consist of the cost of employees, consultants and contractors who design, engineer and develop new products and processes as well as materials, supplies and facilities used in producing prototypes.

The Company's current research and development efforts are primarily focused on improving the Company's products. The Company is also actively involved in identifying new applications. The Company's current internal team along with outside consultants has considerable experience working with the application of the Company's technologies and their applications. The Company engages third party experts as required to supplement the Company's internal team. The Company believes that continued development of new and enhanced technologies is essential to the Company's future success. The Company incurred research and development expenses of $702,771 and $665,203 for the three months ended June 30, 2024 and 2023, respectively, on development activities. The Company incurred research and development expenses of $1,398,137 and $1,339,283 for the six months ended June 30, 2024 and 2023, respectively, on development activities.

Software Development Costs

Costs incurred in the development of software programs for the Company's products are charged to operations as incurred until technological feasibility of the software has been established. Generally, technological feasibility is established when the software module performs its primary functions described in its original specifications, contains features required for it to be usable in a production environment, is completely documented and the related hardware portion of the product is complete. After technological feasibility is established, any additional costs are capitalized. Capitalization of software costs ceases when the software is substantially complete and is ready for its intended use. No software development costs have been capitalized as of June 30, 2024 and December 31, 2023.

Cost of Net Revenues

Cost of net revenues for products includes components and freight. Cost of net revenues for post contract support and other services includes primarily the cost of personnel and personnel-related expenses to conduct implementations and ongoing client support.

Advertising

Advertising costs are charged to selling, general and administrative expenses as incurred. Advertising and marketing costs for the three months ended June 30, 2024 and 2023 were $66,863 and $3,500, respectively. Advertising and marketing costs for the six months ended June 30, 2024 and 2023 were $89,321 and $53,328, respectively.

Shipping and Handling of Products

Amounts billed to customers for shipping and handling of products are included in net revenues. Costs incurred related to shipping and handling of products are included in cost of revenues.

Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This topic also establishes a fair value hierarchy, which requires classification based on observable and unobservable inputs when measuring fair value. The fair value hierarchy distinguishes between assumptions based on market data (observable inputs) and an entity's own assumptions (unobservable inputs). The hierarchy consists of three levels:

Level 1 — Quoted prices in active markets for identical assets and liabilities;

Level 2 — Inputs other than level one inputs that are either directly or indirectly observable; and

Level 3 — Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The recorded value of other financial assets and liabilities, which consist primarily of cash and cash equivalents, accounts receivable, other current assets, accounts payable and accrued expenses approximate the fair value of the respective assets and liabilities as of June 30, 2024 and December 31, 2023 are based upon the short-term nature of the assets and liabilities. The Company recorded its Senior Secured Convertible Promissory Note, earnout liability, and the warrants that were issued with the Convertible Promissory Note at fair value, remeasured on a recurring basis and considered them as Level 3 instruments. The public and private warrants were considered Level 1 and 2 instruments, respectively. The method of determining the fair value of the Senior Secured Convertible Promissory Note and attached warrants is described below.

The Company classifies as liabilities any contracts that (i) require net-cash settlement (including a requirement to net- cash settle the contract if an event occurs and if that event is outside the control of the Company) or (ii) give the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement).

Accounting for Senior Secured Convertible Promissory Notes at Fair Value

The Company has elected the fair value option to account for the senior secured convertible note that was issued on June 22, 2023 and the convertible notes that were issued in October and November 2023 and record them at fair value with changes in fair value recorded in the Consolidated Statements of Operations and Comprehensive Loss. As a result of applying the fair value option, direct costs and fees related to the convertible notes are recognized in earnings as incurred and not deferred. Values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires management to make judgments and consider factors specific to the liability. Considerable judgment is necessary to interpret market data and determine an estimated fair value. The use of different market assumptions or valuation methods may have a material effect on the estimated fair values. As of June 30, 2024, the Company has used a Monte Carlo simulation pricing model that factors in potential outcomes being consummated, such as the convertible notes being repaid in cash and the convertible notes being converted to common stock. All of these scenarios take into consideration the terms and conditions of the underlying convertible notes plus potential changes in the underlying value of the common stock. For the six months ended June 30, 2024, the Company recognized an unrealized loss of $512,184 for the change in fair value of the notes and is included in the Consolidated Statements of Operations and Comprehensive Loss. The Company believes accounting for the convertible notes at fair value better aligns the measurement methodologies of assets and liabilities, which may mitigate certain earnings volatility.

Derivative Liabilities and Earnout Liabilities

The Company does not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks. The Company evaluates all of its financial instruments, including issued share purchase warrants and earnout shares to determine if such instruments are derivatives or contain features that qualify as embedded derivatives, pursuant to ASC 480 and FASB ASC Topic 815, “Derivatives and Hedging” (“ASC 815”). The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period. The Company classifies as liabilities any contracts that (i) require net-cash settlement (including a requirement to net- cash settle the contract if an event occurs and if that event is outside the control of the Company) or (ii) give the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement).

At the merger closing, the Company assumed 515,000 private placement warrants and 16,184,612 public warrants. On June 3, 2024, the Company permanently reduced the exercise price of such warrants from $11.50 per share to an exercise price of $7.80 per share. The purpose of this reduced exercise price was to potentially raise proceeds received from the exercise of such warrants, if any, for working capital and general corporate purposes. As of June 30, 2024, there were 515,000 private placement warrants and 16,159,012 public warrants outstanding. See Note 12– Private Placement and Public Warrants for more information.

Upon consummation of the merger, the Company evaluated the warrants and concluded that they did not meet the criteria to be classified within the stockholders’ deficit. Accordingly, the Company recognizes the warrant instruments as liabilities at fair value and adjusts the instruments to fair value at each reporting period. The initial estimated fair value of the warrants was measured using a Monte Carlo simulation. The subsequent estimated fair value of the public warrants is based on the listed price in an active market for such warrants while the fair value of the private placement warrants continues to be measured using a Monte Carlo simulation with the key inputs being directly or indirectly observable public warrants listed price. Since the public and private warrants meet the definition of a derivative, the Company recorded the public and private warrants as liabilities on the consolidated balance sheet at fair value upon the merger closing, with subsequent changes in the fair value recognized in the consolidated statements of operations at each reporting date.

At the closing of the merger, the Airship AI securityholders that hold shares of common stock of Airship AI, Airship AI options, Airship AI earnout warrants or Airship AI SARs have the contingent right to receive up to 5.0 million additional shares of common stock, subject to certain contingencies. These earnout shares have been categorized into two components: (i) the vested shares that are associated with stockholders with vested equity at the closing of the merger that will be earned upon achievement of the earnout milestones and (ii) the unvested shares associated with stockholders with unvested equity at the closing of the merger that will be earned over the remaining service period with the Company on their unvested equity shares and upon achievement of the earnout milestones.

The earnout shares associated with vested shares are recognized as derivative liabilities in accordance with ASC 815-40, as the events that determine the number of earnout shares required to be released or issued, as the case may be, include events that were not solely indexed to the fair value of common stock of the Company. The earnout shares were measured at the merger closing and subsequently measured at each reporting date until settled or when they met the criteria for equity classification. Accordingly, the Company recognizes the earnout shares as liabilities at fair value and adjusts the instruments to fair value at each reporting period. The earnout shares were valued using a Monte Carlo analysis.

At the closing of the merger, the unvested earnout shares were considered to be equity instruments and valued at approximately $2,675,000. This amount will be recognized as stock-based compensation going forward over the five-year vesting period.

Derivative warrant and earnout shares liabilities are classified as non-current liabilities as their liquidation is not reasonably expected to require the use of significant current assets or require the creation of current liabilities.

Stock-Based Compensation

The Company has share-based compensation plans under which employees, consultants, suppliers and directors may be granted restricted stock, stock appreciation rights, incentive stock options, nonqualified stock options, unvested earnout shares and warrants to purchase shares of common stock at the fair market value at the time of grant. Stock-based compensation cost is measured by the Company at the grant date and the fair value of the award is recognized as an expense, over the requisite service period which is generally the vesting period. The Company adjusts stock-based compensation for changes to the estimate of expected equity award forfeitures based on actual forfeiture experience. The effect of adjusting the forfeiture rate is recognized in the period the forfeiture estimate is changed.

Income Taxes

Income taxes are accounted for using the liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. The Company's ability to realize deferred tax assets depends upon future taxable income, as well as the limitations discussed below. For financial reporting purposes, a deferred tax asset must be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized prior to expiration. The Company considers historical and future taxable income, future reversals of existing taxable temporary differences, taxable income in prior carryback years, and ongoing tax planning strategies in assessing the need for valuation.

Comprehensive Gain

Comprehensive gain is defined as the change in equity of a business during a period from non-owner sources. There was other comprehensive gain of $3,239 and $0 related foreign exchange translation for the three months ended June 30, 2024 and 2023, respectively. There was other comprehensive gain of $8,984 and $42,551 related foreign exchange translation for the six months ended June 30, 2024 and 2023, respectively.

Going Concern Assessment

The Company applies Accounting Standards Codification 205-40 ("ASC 205-40"), *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, which the Financial Accounting Standards Board ("FASB") issued to provide guidance on determining when and how reporting companies must disclose going concern uncertainties in their consolidated financial statements. ASC 205-40 requires management to perform assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's consolidated financial statements (or within one year after the date on which the consolidated financial statements are available to be issued, when applicable). Further, a company must provide certain disclosures if there is "substantial doubt about the entity's ability to continue as a going concern" and management plans to alleviate the going concern.

Use of Estimates

In preparing these consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates and assumptions included in the Company's consolidated financial statements relate to the calculation of revenue recognition, stock-based compensation, valuation of common stock, valuation of senior secured convertible notes, warrant liability, earnout share liabilities, accruals for potential liabilities including income taxes, valuation of deferred tax assets and valuation assumptions related to share-based compensation.

Income (Loss) Per Share

Basic income (loss) per share is based upon the net income (loss) for the three and six months ended June 30, 2024 and 2023 divided by the weighted average shares of common stock outstanding. Diluted net income per share is determined using the weighted average number of common shares and potential common shares (representing the dilutive effect of stock options, warrants, convertible notes payable and stock appreciation rights) outstanding during the period using the treasury stock method for the three months ended June 30, 2024. Common stock equivalents for the six months ended June 30, 2024 and 2023 are not included in the calculation of diluted earnings (loss) per share given the Company incurred a loss and they are anti-dilutive.

Reportable Segments

The Financial Accounting Standards Board, or FASB, Accounting Standard Codification, or ASC, Topic 280, *Segment Reporting*, requires that an enterprise report selected information about reportable segments in its financial reports issued to its stockholders. Management monitors the revenue and expense components of the various products and services the Company offers, but operations are managed and financial performance is evaluated on a corporation-wide basis in comparison to a business plan which is developed each year. Accordingly, all operations are considered by management to be one operating segment and one reportable segment as contained in the Consolidated Statements of Operations and Comprehensive Loss to the consolidated financial statements.

Recent Accounting Pronouncements

All recent accounting pronouncements issued by the FASB, its Emerging Issues Task Force, the American Institute of Certified Public Accountants, and the SEC did not or are not believed by management to have a material impact on the Company's present or future financial statements.

3. Advances due to and from Founders

Advances due to Founders

Prior to 2023, the founders had advanced the Company a net $600,000. In the year ended December 31, 2023, Mr. Huang and Mr. Xu advanced Airship AI a total of $1,350,000 and were repaid a total of $200,000, with $1,750,000 recorded as advances from founders as of December 31, 2023. During 2024, Mr. Huang and Mr. Xu advanced Airship AI $2,100,000 and was repaid $1,300,000, with $2,550,000 recorded as advances from founders as of June 30, 2024. The advances are non-interest bearing and the Company expects to pay the balance off within a one year period.

4. Revenues

Disaggregation of Revenue

The Company's net revenues for the three months ended June 30, 2024 and 2023 consisted of approximately $5.4 million and $1.8 million, respectively, of hardware and software bundled systems for which revenue is transferred at a point in time. The Company's net revenues for the six months ended June 30, 2024 and 2023 consisted of approximately $14.8 million and $3.6 million, respectively, of hardware and software bundled systems for which revenue is transferred at a point in time. The Company's remaining net revenue for the three months ended June 30, 2024 and 2023 of approximately $1 million and $0.96 million, respectively, related to PCS revenue and other services which are transferred over time. The Company's remaining net revenue for the six months ended June 30, 2024 and 2023 of approximately $2.2 million and $2.1 million, respectively, related to PCS revenue and other services which are transferred over time. Within each product category, contract terms, conditions and economic factors affecting the nature, amount, timing, and uncertainty around revenue recognition and cash flow are substantially similar.

Contract Balances

A receivable is recognized in the period the Company delivers goods or provides services or when the Company's right to consideration is unconditional. The Company usually does not record contract assets because the Company has an unconditional right to payment upon satisfaction of the performance obligation, and therefore, a receivable is more commonly recorded than a contract asset. Receivables are generally paid within thirty days and there is no financing element to the customer contracts. As of June 30, 2024 and December 31, 2023, there were no unbilled receivable balances.

The Company's short-term and long-term deferred revenue balances totaled $3,791,970 and $3,878,997 as of June 30, 2024. The Company's short-term and long-term deferred revenue balances totaled $4,008,654 and $4,962,126 as of December 31, 2023. Of the deferred revenue balance of $8,970,780 as of January 1, 2024, the Company recognized approximately $1,000,090 and $2,166,588 during the three and six months ended June 30, 2024, respectively.

Remaining Performance Obligations

As of June 30, 2024, the Company had approximately $7.7 million of remaining performance obligations, which were comprised of deferred service contracts not yet delivered. The Company expects to recognize approximately 27% of its remaining performance obligations as revenue in fiscal 2024 and the remaining 73% in fiscal 2025 and years thereafter.

Costs to Obtain or Fulfill a Contract

The Company does not pay any material variable compensation to obtain a customer contract. Additionally, the majority of the Company's cost of fulfillment as a seller of products is classified as inventory and then cost of revenue when the product is sold. Other costs of contract fulfillment such as software maintenance are expensed in the period incurred and align with when the revenue is amortized.

5. Notes Payable, Line of Credit and Convertible Notes Payable

On June 22, 2023, the Company issued a $2,000,000 senior secured convertible promissory note to Platinum Capital Partners, Inc. As a condition of funding, the Company paid off three small notes and accounts payable totaling $374,000. At the option of the holder, the note is convertible into cash, common stock or a combination of cash and stock. The conversion into the Company's common stock was $6.50 per share as of December 31, 2023. The repayment amount of the note is 110% ($2,200,000) and had an original maturity date of June 22, 2024. Interest on the note is 6% per annum calculated on 360 days. In connection with the convertible notes transaction, the Company issued warrants to purchase 53,800 shares of common stock with an exercise price of $6.50 upon the conclusion of the BYTS merger. The value of the warrants totaled $15,418 and reduced the fair value of the convertible promissory notes.

On February 2, 2024, the Company issued in a private placement an amended and restated senior secured convertible promissory note to Platinum in the principal amount of $2,000,000. The Platinum convertible note amends and restates in its entirety the senior secured convertible promissory note issued to Platinum in the principal amount of $2,000,000 on June 22, 2023. The repayment amount of the Platinum convertible note is 110% of the principal amount ($2,200,000) and had an original maturity date of June 22, 2024. Interest accrues on the Platinum convertible note at the rate of 6% per annum calculated on the basis of 360 days. At the option of Platinum, the principal amount of the Platinum convertible note plus any accrued but unpaid interest is convertible into shares of common stock at a conversion price per share equal to the lower of (i) $3.69717, subject to appropriate adjustment as provided in the Platinum convertible note, and (ii) 65% of the VWAP for the common stock for the preceding five trading days immediately prior to any conversion, but in no event below $2.27518, subject to appropriate adjustment as provided in the Platinum convertible note. The Platinum convertible note contains "weighted average" anti-dilution protection for issuances of shares of common stock or common stock equivalents at a price less than the conversion price then in effect.

In connection with the issuance of the Platinum convertible note, the Company also issued to Platinum an amended and restated common stock purchase warrant dated February 2, 2024 to purchase 189,334 shares of common stock at an exercise price per share of $3.69717. The term of the Platinum warrant expires on June 22, 2028. The Platinum convertible note may not be converted, and the Platinum warrant may not be exercised, to the extent that after giving effect to such conversion and/or exercise, Platinum (together with its affiliates) would beneficially own in excess of 4.99% of the common stock outstanding immediately after giving effect to such conversion and/or exercise. On March 18, 2024, Platinum exercised the Platinum warrant and received 137,367 shares of common stock. Platinum forfeited 51,967 shares.

On June 22, 2024, the Company entered into an Extension Agreement related to the Platinum convertible note. The Extension Agreement extended the due date of the Platinum convertible note from June 22, 2024 to June 22, 2025. The Company issued 232,360 shares of the Company's restricted common stock in payment of all interest and extension fees through June 22, 2025 with a value of $1,008,400. Approximately $487,000 of the total payment related to the future interest period and was recorded in prepaid expenses and others on the consolidated balance sheet. Subject to the terms and conditions of such Extension Agreement, for a period commencing on December 22, 2024 and ending at the close of business on December 22, 2025, Platinum has a one-time put right to have the Company purchase all or a portion of Platinum's 232,360 restricted shares at $2.27518 per share. The Company granted piggyback registration rights to Platinum.

At the option of Platinum, the $2,000,000 principal amount of the note is convertible into shares of the Company's common stock at a conversion price per share equal to the lower of (i) $3.69717, subject to appropriate adjustment as provided in the note, and (ii) 65% of the VWAP of the common stock for the five trading days immediately prior to any conversion, but in no event below $2.27518, subject to appropriate adjustment as provided in the note. The note contains "weighted average" anti-dilution protection for issuances of shares of common stock or common stock equivalents at a price less than the conversion price then in effect.

The obligations under the note are secured by a blanket lien on all assets of the Company pursuant to an Amended and Restated Security Agreement dated February 2, 2024 and are guaranteed pursuant to an Amended and Restated Guaranty dated February 2, 2024. The Company also concurrently entered into an Amended and Restated Subordination Agreement.

On October 3, 2023, the Company issued senior secured convertible promissory notes for $600,000 to two private investors. At the option of the holders, the notes are convertible into cash, common stock or a combination of cash and stock. The repayment amount of the notes is 110% ($660,000) and mature on September 30, 2024. Interest on the notes is 6% per annum calculated on the basis of 360 days. On March 5, 2024, the two private investors converted senior secured convertible promissory notes with a face value of $600,000 and interest into 169,204 shares of the Company's common stock valued at $835,610. The Company recognized a loss on debt conversion of $158,794 during the three and six months ended June 30, 2024.

The Company accounts for the notes under the fair value method of accounting and as of June 30, 2024 and December 31, 2023, the notes were recorded at $2,675,919 and $2,825,366. During the six months ended June 30, 2024, the Company

recorded an increase in the fair value of the convertible notes payable totaling $512,184 which was recorded as loss from change in fair value of convertible debt on the statement of operations and comprehensive loss. See Note 14 – Fair Value Measurements for more information.

6. Stockholders' Deficit

Authorized and Outstanding Stock

The Company is a Delaware company and its affairs are governed by its certificate of incorporation, its bylaws and the Delaware General Corporation Law and the common law of the State of Delaware. The Company's charter authorizes the issuance of 205,000,000 shares, consisting of 200,000,000 shares of common stock and 5,000,000 shares of preferred stock, par value $0.0001 per share.

Details on the common stock, preferred stock and equity incentive plans were disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2023 and filed with the SEC on April 1, 2024.

Common Stock

As of June 30, 2024, there were 23,736,027 shares of common stock outstanding.

Six Months Ended June 30, 2024

During the six months ended June 30, 2024, the Company had the following sales of unregistered equity securities:

On March 5, 2024, a private investor converted a senior secured convertible promissory note for $250,000 and interest into 70,502 shares of the Company's common stock.

On March 5, 2024, a private investor converted a senior secured convertible promissory note for $350,000 and interest into 98,702 shares of the Company's common stock.

On March 21, 2024, the Company issued 15,000 shares of common stock for services performed as of December 31, 2023 to MZHCI, LLC related to an investor relations consulting agreement.

On May 16, 2024, the Company issued 50,000 shares of common stock to Pamria LLC for consulting and investor relations services.

On June 22, 2024, the Company entered into an extension agreement with Platinum Capital Partners Inc. to extend the maturity date of the Platinum convertible note to June 22, 2025. In consideration for entering into the extension agreement, the Company agreed to issue to Platinum 232,360 shares of common stock.

In June 2024, the Company issued an aggregate of 294,448 shares of common stock upon the exercise of stock options at exercise prices ranging from $0.12 to $1.64 per share.

2023 Equity Incentive Plan

The Company has adopted the 2023 Equity Incentive Plan, which plan was approved by stockholders at the extraordinary general meeting held in December 2023. Details on the equity incentive plan were disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2023 and filed with the SEC on April 1, 2024.

The aggregate number of shares of common stock initially reserved and available for grant and issuance under the equity incentive plan is 4,080,000 as of June 30, 2024. Such aggregate number of shares of stock will automatically increase on January 1 of each year for a period of ten years commencing on January 1, 2024 and ending on January 1, 2033, in an amount equal to 2.0% of the total number of shares of common stock outstanding on December 31 of the preceding year.

The Company had the following stock option activity during the six months ended June 30, 2024:

During the six months ended June 30, 2024, the Company granted stock options to six employees to purchase an aggregate of 525,000 shares of common stock with an exercise price of $4.61 and which vest primarily quarterly over four years and expire on March 31, 2034.

Stock option activity for the six months ended June 30, 2024 was as follows:

	Options Shares	Weighted Average Exercise Price	Potential Proceeds
Outstanding as of December 31, 2023	4,664,589	$ 0.55	$ 2,545,765
Granted	525,000	4.61	2,420,750
Exercised	(294,448)	(0.50)	(146,972)
Outstanding as of June 30, 2024	4,895,141	$ 0.98	$ 4,819,543

The following table summarizes information about stock options outstanding and exercisable as of June 30, 2024:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life In Years	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price Exercisable
$ 0.12	2,495,803	3.84	$ 0.12	2,495,803	$ 0.12
0.57	922,963	4.02	0.57	922,963	0.57
1.49-1.65	1,126,562	7.93	1.64	483,625	1.64
1.90	49,813	3.48	1.90	6,227	1.90
6.59-7.61	300,000	9.75	6.84	18,750	6.84
	4,895,141	5.17	$ 0.98	3,927,367	$ 0.45

There were 4,895,141 options to purchase common stock at an average exercise price of $0.98 per share outstanding as of June 30, 2024 under the 2023 Equity Incentive Plan. The Company recorded $261,636 and $136,709 of compensation expense, net of related tax effects, relative to stock options for the three months ended June 30, 2024 and 2023, respectively. The Company recorded $530,625 and $273,418 of compensation expense, net of related tax effects, relative to stock options for the six months ended June 30, 2024 and 2023, respectively, in accordance with ASC 718. As of June 30, 2024, there was $ 1,553,651 of total unrecognized costs related to employee granted stock options that were not vested. These costs are expected to be recognized over a period of approximately 4.75-5.17 years.

The significant weighted-average assumptions relating to the valuation of the Company's stock option grants were as follows for the three months ended:

Assumptions	6/30/2024	3/31/2024
Estimated stock price	$ 7.61	$1.49-$6.59
Exercise price	$ 7.61	$1.49-$6.59

Dividend yield	0%	0%
Expected life	4 years	5-10 years
Expected volatility	69%	69%
Risk free interest rate	4.68%	4.23%

There were stock incentive plan awards outstanding at June 30, 2024 totaling 4,895,141 shares with an aggregate intrinsic value of $13,728,765.

As of June 30, 2024 and December 31, 2023 there were 1,758,000 SARs outstanding. There were no SAR grants in the six months ended June 30, 2024 or the year ended December 31, 2023.

Warrants to Purchase Common Stock

See Note 12 for public and private placement warrants assumed after the merger.

The Company had the following warrant activity during the six months ended June 30, 2024:

In connection with the issuance of the Platinum convertible note, the Company also issued to Platinum an amended and restated common stock purchase warrant dated February 2, 2024 to purchase 189,334 shares of common stock at an exercise price per share of $3.69717. The term of the Platinum warrant expires on June 22, 2028. The Platinum convertible note may not be converted, and the Platinum warrant may not be exercised, to the extent that after giving effect to such conversion and/or exercise, Platinum (together with its affiliates) would beneficially own in excess of 4.99% of the common stock outstanding immediately after giving effect to such conversion and/or exercise. On March 18, 2024, Platinum exercised the Platinum warrant and received 137,367 shares of common stock. Platinum forfeited 51,967 shares.

During the six months ended June 30, 2024, investors exercised warrants for 25,600 shares of the Company's common stock at $11.49 per share and the Company received proceeds of $293,249.

A summary of the warrants outstanding as of June 30, 2024 were as follows:

	June 30, 2024	
	Shares	Weighted Average Exercise Price
Outstanding January 1, 2024	19,443,314	$ 10.16
Issued	135,534	3.70
Exercised	(162,967)	(4.92)
Forfeited	(51,967)	(3.70)
Expired	-	-
Outstanding at June 30, 2024	19,363,914	$ 6.96

June 30, 2024				
Number of Warrants	Weighted Average Remaining Life (In Years)	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Exercise Price
2,689,902	3.85	$ 1.77	2,689,902	$ 1.77
515,000	4.42	7.80	515,000	7.80
16,159,012	4.42	7.80	16,159,012	7.80
19,363,914	4.40	$ 6.96	19,363,914	$ 6.96

The significant weighted average assumptions relating to the valuation of the Company's warrants issued for the six months ended June 30, 2024 were as follows:

Assumptions	
Dividend yield	0%
Expected life	3-5 years
Expected volatility	69%
Risk free interest rate	4.23%

Warrants for 19,363,914 shares had an aggregate intrinsic value of $4,895,622 as of June 30, 2024.

Earnout Liability

See Note 13 for common stock shares related to earnout liability.

In addition, a portion of the earnout shares may be issued to individuals with unvested equity awards. While the payout of these shares requires the achievement of the earnout milestones, the individuals must complete the remaining service period associated with these unvested equity awards to be eligible to receive the earnout shares. As a result, these unvested earn-out shares are equity-classified awards and have an aggregated grant date fair value of $2,675,223 (or $5.96 per share). During the three and six months ended June 30, 2024, the Company stock-based compensation expense for the vesting of earnout shares was $133,761 and $267,522, respectively. As of June 30, 2024, unrecognized compensation cost related to unvested earnout shares totaled $2,407,702. The weighted average period over which this remaining compensation cost is expected to be recognized is 4.5 years.

7. Employee 401(k) Plan

The Company has a 401(k) plan for its employees. The plan provides for a 3.5% match on up to 6% of deferred salary The Company expensed $50,696 and $47,563 of contributions during the three months ended June 30, 2024 and 2023, respectively. The Company expensed $100,798 and $93,559 of contributions during the six months ended June 30, 2024 and 2023, respectively.

8. Related Party Transactions

Advances due to Founders

Prior to 2023, the founders had advanced the Company a net $600,000. In the year ended December 31, 2023, Mr. Huang and Mr. Xu advanced Airship AI a total of $1,350,000 and were repaid a total of $200,000, with $1,750,000 recorded as advances from founders as of December 31, 2023. During 2024, Mr. Huang and Mr. Xu advanced Airship AI $2,100,000 and was repaid $1,300,000, with $2,550,000 recorded as advances from founders as of June 30, 2024. The advances are non-interest bearing and the Company expects to pay the balance off within a one year period.

9. Commitments, Contingencies and Legal Proceedings

Legal Proceedings

The Company may from time to time become a party to various legal proceedings arising in the ordinary course of its business. The Company is currently not a party to any pending legal proceeding that is not ordinary routine litigation incidental to its business.

Properties and Operating Leases-Right of Use Asset and Lease Liability

Lease agreements are evaluated to determine whether an arrangement is or contains a lease in accordance with ASC 842, *Leases*. Right of use lease assets and lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at the commencement date. The incremental borrowing taking into consideration the Company's credit quality and borrowing rate for similar assets is used in determining the present value of future payments. Lease expense is recorded as general and administrative expenses on the Company's consolidated statements of operations.

On May 1, 2019, the Company leased 31,765 square feet for its executive offices in Redmond, Washington. The Company's net monthly payment was $44,440. The monthly payment increased approximately 3% each year and the lease was set to expire on April 30, 2024. The Company had two five-year renewal options. In April 2023, the Company and its landlord entered into an agreement whereby the Company's office lease was terminated on September 30, 2023.

On July 13, 2023, the Company entered into a new lease in Redmond, WA for 15,567 square feet of office and warehouse space which starts October 1, 2023. The monthly payment is $25,000 per month. The lease expires October 31, 2027 and the monthly payment increases 3% on July 31, 2024 and each year thereafter. There is a one three year option to extend based on the fair market rate on October 31, 2027.

On January 1, 2021, the Company leased offices located in Moorestown, North Carolina. The Company leases 3,621 square feet and the net monthly payment was $4,828. The monthly payment increases approximately 3%-6% annually thereafter. The lease expired on February 28, 2024. On February 29, 2024, the Company extended the lease and the net monthly payment is $6,488. The lease expires on August 29, 2024.

The Company has entered into operating leases for office and development facilities for four years and include options to renew. The Company determines whether an arrangement is or contains a lease based upon the unique facts and circumstances at the inception of the lease. Operating lease liabilities and their corresponding right-of-use assets are recorded based upon the present value of the lease payments over the expected lease term. As of June 30, 2024 and December 31, 2023, total operating lease liabilities was approximately $993,995 and $1,118,578, respectively. Right of use assets totaled approximately $953,713 and $1,104,804 at June 30, 2024 and December 31, 2023, respectively. Current lease liabilities were $198,002 and $174,876 at June 30, 2024 and December 31, 2023, respectively. In the three months ended June 30, 2024 and 2023, the Company recognized $128,124 and $162,414 in total lease costs for the leases, respectively. In the six months ended June 30, 2024 and 2023, the Company recognized $227,067 and $324,828 in total lease costs for the leases, respectively. Because the rate implicit in each lease is not readily determinable, the Company uses its estimated incremental borrowing rate to determine the present value of the lease payments.

The weighted average remaining lease term for the operating leases was forty three months at June 30, 2024 and the weighted average discount rate was 7 %.

The minimum future lease payments as of June 30, 2024 are as follows:

Years Ended June 30,		
2025	$	261,752
2026		364,885
2027		375,859
2028		128,397
Total remaining payments		1,130,893
Less Imputed Interest		(136,898)
Total lease liability	$	993,995

Employment Agreement

On March 1, 2024, the Company entered into an employment agreement with Mark E. Scott, the Company's Chief Financial Officer, which provides for a base salary of $250,000 annually. Mr. Scott is also eligible to participate in annual performance-based bonus programs established by the board or compensation committee, subject to the achievement of applicable performance criteria established by the board or compensation committee, which shall be determined in good faith by the board or compensation committee. Mr. Scott was also granted options to purchase up to twenty five thousand (25,000) shares of common stock with an exercise price equal to $1.49, which options vested in full on the date of issuance.

10. Income Taxes

The Company recorded a provision for income taxes of $0 for the six months ended June 30, 2024 and 2023.

The Company's effective tax rate was 0% for the six months ended June 30, 2024 and 2023. The difference between the effective tax rate and the federal statutory tax rate for the six months ended June 30, 2024 and 2023 primarily related to the valuation allowance on the Company's deferred tax assets.

For interim periods, the Company estimates its annual effective income tax rate and applies the estimated rate to the year-to-date income or loss before income taxes. The Company also computes the tax provision or benefit related to items reported separately and recognizes the items net of their related tax effect in the interim periods in which they occur. The Company also recognizes the effect of changes in enacted tax laws or rates in the interim periods in which the changes occur.

As of June 30, 2024 and December 31, 2023, the Company retains a full valuation allowance on its deferred tax assets. The realization of the Company's deferred tax assets depends primarily on its ability to generate taxable income in future periods. The amount of deferred tax assets considered realizable in future periods may change as management continues to reassess the underlying factors it uses in estimating future taxable income.

11. Reverse Recapitalization

On December 21, 2023, the Company completed the merger and received net proceeds of $2.8 million, net of transaction costs of $6.6 million.

The merger was accounted for as a reverse recapitalization in accordance with GAAP. Under this method of accounting, BYTS, who was the legal acquirer, was treated as the "acquired" company for accounting purposes and Airship AI was treated as the accounting acquirer. Accordingly, the merger was treated as the equivalent of Airship AI issuing shares at the closing of the merger for the net assets of BYTS as of the closing date, accompanied by a recapitalization. The net assets of BYTS was stated at historical cost, with no goodwill or other intangible assets recorded. Airship AI was determined to be the accounting acquirer based on evaluation of the following facts and circumstances:

- Airship AI's stockholders have the majority voting interest in the combined company;
- The board of the post-merger company is composed of one (1) director designated by BYTS and four (4) directors designated by Airship AI;
- Airship AI's senior management is the senior management of the post-merger company;
- The business of Airship AI comprises the ongoing operations of post-merger company; and
- Airship AI is the larger entity, in terms of substantive assets.

The table below summarizes the shares of common stock issued immediately after the closing of the merger as well as the impact on the consolidated statement of stockholders' equity as of December 21, 2023:

	Shares	Par Amount	Common Stock	Additional Paid in Capital	Accumulated Deficit
SPAC Financing	8,891,718	$ 0.0001	$ 889	$ 8,315,186	$ -
Transaction expenses (1)	532,986	0.0001	53	(6,651,674)	(894,662)
Earnout liability				(4,470,918)	(22,638,859)
Warrants liability				(2,009,105)	-
Reverse capitalization on December 21, 2023 (1)	9,424,704		$ 942	$ (4,816,511)	$ (23,533,521)

(1) *Adjusted for correction of transaction expense discussed below.*

Immaterial Revision of Prior Period Financial Information

In connection with the preparation of its consolidated financial statements, the Company identified an immaterial error related to the classification of prepaid expenses and transaction expenses (classified in accumulated deficit as reverse recapitalization). In accordance with SAB No. 99, "Materiality," and SAB No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements," the Company evaluated the error and determined that the impact was not material to its financial statements for the prior annual and current interim period, accordingly the Company revised the prior period financial information for comparative purposes. The revision does not impact the consolidated statements of operations and comprehensive loss. A summary of the revision to the Company's previously reported consolidated balance sheets is included below for comparative purposes:

	As of December 31, 2023		
	As Reported	Adjustment	As Revised
Prepaid expenses and other	$ 913,030	$ (894,662)	$ 18,368
Total current assets	5,693,577	(894,662)	4,798,915
Total assets	6,982,575	(894,662)	6,087,913
Accumulated deficit	(16,582,038)	(894,662)	(17,476,700)
Total stockholders' deficit	(16,592,565)	(894,662)	(17,487,227)

The revision had no impact to cash provided by operating activities in such period.

12. Private Placement and Public Warrants

At the merger closing, the Company assumed 515,000 private placement warrants and 16,184,612 public warrants. On June 3, 2024, the Company permanently reduced the exercise price of such warrants from $11.50 per share to an exercise price of $7.80 per share. The purpose of this reduced exercise price was to potentially raise proceeds received from the exercise of such warrants, if any, for working capital and general corporate purposes. As of June 30, 2024, there were 515,000 private placement warrants and 16,159,012 public warrants outstanding.

Details on the warrants were disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2023 and filed with the SEC on April 1, 2024. The public warrants will expire on December 21, 2028.

The following table is a summary of the number of shares of the Company's common stock issuable upon exercise of the public and private warrants outstanding as of June 30, 2024:

	Number of Shares	Exercise Price	Expiration Date	Fair Value
Public Warrants	16,159,012	$ 7.80	December 21, 2028	5,828,609
Private Warrants	515,000	$ 7.80	December 21, 2028	144,120

13. Earnout Liability

Certain of the Company's stockholders are entitled to receive up to 5,000,000 earnout shares of the Company's common stock if the following earnout milestones are met.

(A) 25% of the earnout shares if, for the period starting on the closing date and ending on the last day of the full calendar quarter immediately following the first anniversary of the closing date, (1) Company Revenue (as defined below) is at least $39 million, or (2) the aggregate value of new contract awards (including awards obtained through purchase orders) with federal law enforcement agencies (whether such awards are obtained directly or through intermediaries) has grown by at least 100% as compared to the year-over-year amount for the twelve-month period ending on the date of the Merger Agreement (the "First Operating Performance Milestone");

(B) 75% of the earnout shares if, for the period starting on the closing date and ending on the last day of the full calendar quarter immediately following the third anniversary of the closing date, Company Revenue is at least $100 million (the "Second Operating Performance Milestone");

(C) 50% of the earnout shares if, at any time during the period starting on the closing date and ending on the fifth anniversary of the closing date, over any twenty (20) trading days within any thirty (30) trading day period the volume weighted average price ("VWAP") of the common stock is greater than or equal to $12.50 per share (the "First Share Price Performance Milestone"); and

(D) 50% of the earnout shares if, at any time during the period starting on the closing date and ending on the fifth anniversary of the closing date, over any twenty (20) trading days within any thirty (30) trading day period the VWAP of the common stock is greater than or equal to $15.00 per share (the "Second Share Price Performance Milestone").

Further, the earnout milestones are also considered to be met if the Company undergoes a change of control. A change of control is defined as (i) any transaction or series of related transactions that results in any Person or "group" (within the meaning of Section 13(d)(3) of the Exchange Act) acquiring equity interests that represent more than 50% of the total voting power of the Company or (ii) a sale or disposition of all or substantially all of the assets of the Company and its subsidiaries on a consolidated basis.

Notwithstanding anything in the Merger Agreement to the contrary, any earnout shares issuable under the Merger Agreement to a Airship AI securityholder in respect of each Airship AI option or Airship AI SAR held by such holder as of immediately prior to the effective time of the merger shall be earned by such holder on the later of (i) the occurrence of the applicable earnout milestone, and (ii) the date on which the option in respect of such Airship AI option or SAR in respect of such Airship AI SAR, as applicable, becomes vested pursuant to its applicable vesting schedule, but only if such holder continues to provide services (whether as an employee, director or individual independent contractor) to the Company or one of its subsidiaries through such date. Notwithstanding the foregoing, any earnout shares that are not earned by a Airship AI securityholder in respect of its options or SARs on or before the fifth anniversary of the closing date of the merger shall be forfeited without any consideration. Any earnout shares that are forfeited pursuant to the Merger Agreement shall be reallocated to the other Airship AI securityholders who remain entitled to receive earnout shares in accordance with their respective earnout pro rata shares.

These earnout shares have been categorized into two components: (i) the "Vested Shares" - those associated with earnout holders with vested equity at the closing of the merger that will be earned upon achievement of the earnout milestones and (ii) the "Unvested Shares" - those associated with earnout holders with unvested equity at the closing of the merger that will be earned over the remaining service period with the Company on their unvested equity shares and upon achievement of the earnout milestones. The Vested Shares, which represent 95% of the total earnout shares are classified as liabilities in the consolidated balance sheet at fair value with changes in fair value recognized in the consolidated statements of operations due to the variability in the number of earnout shares at settlement which could change upon a change of control event. The earnout arrangement contains a settlement provision that violates the indexation guidance under ASC 815-40. The Unvested Shares are equity-classified share-based compensation to be recognized over time under ASC 718 due to the service component.

At the closing of the merger on December 21, 2023, the earnout liability had an initial fair value of $27,109,777, which was recorded as a long-term liability and a reduction to additional paid in capital in the consolidated balance sheet. As of December 31, 2023, the earnout liability had decreased to $5,133,428 as a result of the decline in the Company's share price since the closing of the merger. As of June 30, 2024, the estimated fair value of the earnout liability increased to $ 11,741,351 primarily due to the increase in the Company's share price, which resulted in a loss due to the change in fair value of the earnout liability during the six months ended June 30, 2024 of $6,607,923 and is recorded on the consolidated statements of operations and comprehensive loss. See Note 14– Fair Value Measurements for more information.

As of June 30, 2024, the Company is currently evaluating the earnout shares to determine the first operating performance milestone has been met.

14. Fair Value Measurements

The following table sets forth by level within the ASC 820, Fair Value Measurement, fair value hierarchy of the Company's liabilities that are measured at fair value on a recurring basis as of June 30, 2024:

	June 30, 2024			
	Level 1	Level 2	Level 3	Total
Liabilities				
Earnout liability	$ -	$ -	$ 11,741,351	$ 11,741,351
Senior Secured Convertible Promissory Notes	-	-	2,675,919	2,675,919
Warrant liability (Public Warrants)	5,828,609	-	-	5,828,609
Warrant liability (Private Warrants)	-	144,120	-	144,120
Total liabilities measured at fair value	$ 5,828,609	$ 144,120	$ 14,417,270	$ 20,389,999

The following table sets forth by level within the ASC 820, Fair Value Measurement, fair value hierarchy of the Company's liabilities that are measured at fair value on a recurring basis as of December 31, 2023:

	December 31, 2023			
	Level 1	Level 2	Level 3	Total
Liabilities				
Earnout liability	$ -	$ -	$ 5,133,428	$ 5,133,428
Senior Secured Convertible Promissory Notes	-	-	2,825,366	2,825,366
Warrant liability (Public Warrants)	646,428	-	-	646,428
Warrant liability (Private Warrants)	-	21,557	-	21,557
Total liabilities measured at fair value	$ 646,428	$ 21,557	$ 7,958,794	$ 8,626,779

The estimated fair value of the earnout liability was determined using a Monte Carlo Model. The assumptions utilized in the calculation are based on the achievement of certain stock price milestones including projected stock price, volatility, probability of meeting the federal law enforcement agency growth and risk-free rate. The following assumptions were used in the simulation at each valuation date:

	June 30, 2024	December 31, 2023
Stock price	$ 3.59	$ 1.70
Risk-free interest rate	4.33%	3.84%
Expected term (in years)	4.5	5
Expected volatility	62.9%	75.9%
Dividend yield	0%	0%

The assumptions also included the probability of meeting the federal law enforcement agency growth milestone at 100%.

The initial estimated fair value of the private warrants was measured using a Monte Carlo simulation. The estimated fair value of the public warrants is based on the listed price in an active market for such warrants and the fair value of the private placement warrants continues to be measured based on the public warrants listed price.

The estimated fair value of the senior secured convertible promissory notes was measured using a Monte Carlo simulation pricing model that factors in potential outcomes being consummated, such as the convertible notes being repaid in cash and the convertible notes being converted to common stock. All of these scenarios take into consideration the terms and conditions of the underlying convertible notes plus potential changes in the underlying value of the common stock. The following assumptions were used in the simulation:

	June 30, 2024	December 31, 2023
Stock price	$ 3.59	1.70
Effective discount rate	14.83%	12.95%
Expected term (in years)	0.98	0.48 to 0.75
Expected volatility	56.9%	62.5%
Dividend yield	0%	0%

There were no transfers of financial instruments between valuation levels during the three and six months ended June 30, 2024 and the year ended December 31, 2023.

15. Earnings per Share

The following table sets forth the computation of basic and diluted net income (loss) per share attributable to common stockholders:

	June 30, 2024 Three months ended	June 30, 2024 Six months ended	June 30, 2023 Three months ended	June 30, 2023 Six months ended
Net income (loss) - Basic	$ 18,461,995	$ (13,502,474)	$ (3,103,279)	$ (4,815,455)
Less: interest expense and remeasurement of convertible debt	(1,005,611)	-	-	-
Net income (loss) - Diluted	$ 17,456,384	$ (13,502,474)	$ (3,103,279)	$ (4,815,455)
Weighted average shares outstanding:				
Basic	23,220,709	23,059,598	22,812,048	22,812,048
Add: dilutive effect of convertible debt, stock options, SARs and Airship warrants	7,051,519	-	-	-
Diluted	30,272,228	23,059,598	22,812,048	22,812,048
Income (loss) per share				
Basic	$ 0.80	$ (0.59)	$ (0.14)	$ (0.21)
Diluted	$ 0.58	$ (0.59)	$ (0.14)	$ (0.21)

The following potentially dilutive shares were not included in the calculation of diluted shares outstanding for the periods presented as the effect would have been anti-dilutive:

	June 30, 2024	December 31, 2023
Public Warrants	16,159,012	16,184,612
Private Warrants	515,000	515,000
Convertible debt	-	452,240
Warrants	-	53,800
Outstanding stock options	300,000	-
	16,974,012	17,205,652

The 5,000,000 earnout shares are excluded from basic and diluted net loss per share as such shares are contingently issuable until the Company exceeds certain milestone thresholds that have not been achieved. As of June 30, 2024, the Company is currently evaluating the earnout shares to determine if the first operating performance milestone has been met.

As a result of the merger, the weighted-average number of shares of Common Stock used in the calculation of net income (loss) per share have been retroactively converted by applying the conversion ratio.

16. Subsequent Events

The Company evaluated subsequent events, for the purpose of adjustment or disclosure, up through the date the financial statements were issued. Subsequent to June 30, 2024, there were no material transactions that require disclosure.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion and analysis summarizes the significant factors affecting our operating results, financial condition, liquidity and cash flows as of and for the periods presented below. The following discussion and analysis should be read in conjunction with our financial statements and the related notes thereto included elsewhere in this report. The discussion contains forward-looking statements that are based on the beliefs of management, as well as assumptions made by, and information currently available to, management. Actual results could differ materially from those discussed in or implied by forward-looking statements as a result of various factors, including those discussed below and elsewhere in this report, particularly in the sections titled "Risk Factors" and "Special Note Regarding Forward-Looking Statements."

Overview

We are a robust AI-driven data management platform that solves complex data challenges for large institutions operating in dynamic and mission-critical environments with rapidly increasing volumes of data being ingested from a similarly rapidly growing number of data sources.

We solve these challenges by structuring "dark" or unstructured data at the edge, the location at which the data is generated and collected, and leveraging purpose-built AI models. Unstructured, or "dark" data, which is typically categorized as qualitative data, cannot be processed and analyzed via conventional data tools and methods. Conversely, structured data, typically categorized as quantitative data, is highly organized and easily decipherable by machine learning algorithms.

Structuring and then analyzing data using AI models at the edge, versus transmitting the data from the edge back to a central processing location for structuring and analysis, enables real-time decision making and data-driven operational efficiency.
We specialize in ingesting all available metadata from edge-based sensors used by government and law enforcement agencies around the world, including surveillance cameras (video), audio, telemetry, acoustic, seismic, and autonomous devices, along with large commercial corporations with fundamentally similar capabilities and requirements.

Data generated by these edge-based sensors, including video, can then be run through our trained AI models to detect objects present within the video frame. Once an object is detected, for example an automobile, additional identifying characteristics of the object can be extracted from the image including the license plate characters and the make, model, and color of the automobile. This process of analyzing, logging and categorizing ingested data is referred to as "structuring" the data.

Airship AI's software allows customers to view structured data both in real-time as well as to conduct searches on the structured data at a later point in time. Real-time structured data use includes, for example, alarms on a specific license plate or a specific make, model or color of automobile. Non-real-time structured data use includes, for example, searching a database of video data that has been previously ingested and stored to find instances of a particular license plate being visible, along with other logged vehicle characteristics such as make, model and color of an automobile.

Additional edge deployed AI models enable similar object detection and recognition of common and custom trained objects, such as an aircraft, boat, person, animal, bag, or weapon. Airship AI's models provide similar data points for these object types allowing analysts the ability to be notified in real-time of the detection of a specified object and similarly search for historically detected objects. Examples include detecting aircrafts and boats along with their respective tail numbers and hull registration numbers.

Our AI modelling process starts with pre-trained AI models from our technology ecosystem partners which we then customize using proprietary datasets tailored towards our customers unique workflow requirements. Where customers have pre-existing AI models or engines, we integrate those models or engines into our edge platform allowing customers to leverage proprietary models within the Airship AI software ecosystem.

Our primary offerings include Outpost AI, Acropolis, and Airship Command. Our offerings allow customers to manage their data across the full data lifecycle, when and where they need it, using a highly secure permissioned based architecture.

Recent Developments

On June 27, 2023, BYTS entered into the Merger Agreement with Merger Sub and Airship AI. The Merger Agreement was amended on September 22, 2023. On December 21, 2023, the merger with BYTS closed. Airship AI Holdings, Inc. became the accounting acquiror and the combined entity became the successor SEC registrant under the ticker symbol "AISP".

Fair Value Transactions

As a result of the merger, the Company entered into the following transactions that were measured at fair value and vary quarterly with the share price and other items. Any change is non-cash and is recorded as a gain or loss in other income (expense). See Note 14– Fair Value Measurements for more information.

	Liability as of June 30, 2024	Liability as of December 31, 2023
Earnout liability	$ 11,741,351	$ 5,133,428
Senior Secured Convertible Promissory Notes	2,675,919	2,825,366
Warrant liability (Public Warrants)	144,120	646,428
Warrant liability (Private Warrants)	5,828,609	21,557
Total liabilities measured at fair value	$ 20,389,999	$ 8,626,779
Other loss related to instruments recorded at fair value during the six months ended June 30, 2024	$ (12,424,851)	
Other loss related to instruments recorded at fair value during the six months ended June 30, 2023	$ -	

Private Placement and Public Warrants

At the merger closing, we assumed 515,000 private placement warrants and 16,184,612 public warrants. On June 3, 2024, we permanently reduced the exercise price of such warrants from $11.50 per share to an exercise price of $7.80 per share. The purpose of this reduced exercise price was to potentially raise proceeds received from the exercise of such warrants, if any, for working capital and general corporate purposes. As of June 30, 2024, there were 515,000 private placement warrants and 16,159,012 public warrants outstanding. See Note 12– Private Placement and Public Warrants for more information.

Key Performance Indicators

Historically, a majority of our product revenue has consisted primarily of a bundled hardware and software product and to date we have sold or licensed a minimal amount of standalone software. In the future, we expect to see more delivery of our products using a cloud based software solution which will allow us to create additional subscription revenue.

We have historically evaluated our business solely based on revenue generated from customers and we have not tracked any other customer-related metrics. As we grow and increase our product offerings and customer base, we intend to modify and develop more advanced performance indicators. We believe the following key performance indicators apply to us in the future:

- *Growth within existing government customers*. While we currently have a strong footprint across multiple large U.S. government agencies, growing our business within these agencies outside of the investigation focused departments is a fundamental area of our projected growth. Our ability to expand our footprint by implementing AI based solutions that leverage our core existing competencies within the agencies will be a critical indicator of the success of this strategy. We will measure progress against this objective through the disclosure of awards for new business within these agencies during the affected timeframe, providing tangible evidence of the success of our strategy to both management and investors alike.

- *Greater penetration into the commercial marketplace*. While we have several existing customers in the commercial marketplace, our ability to build on the solutions we provide those customers and expand that base will be critical to our projected growth objectives. We will measure progress against this objective through the disclosure of the number of new commercial customers added during the affected timeframe, providing tangible evidence of the success of our strategy to both management and investors alike.

- *Expansion of our edge AI based solutions*. We began to sell AI based solutions in late 2022. Our current strategy is highly focused on the transition of data management and analysis workloads to the edge, driving efficiency and cost savings for our customers. This strategy also includes new models being trained to extract data at the edge which enables real-time intelligent decision making for our customers. We will measure progress against this objective through the disclosure of the numbers of edge AI hardware devices we are selling as well as the growth of our edge AI analytic capabilities, providing tangible evidence of the success of our strategy to both management and investors alike.

Principal Factors Affecting Our Financial Performance

We believe the following factors and trends may cause previously reported financial information not to be necessarily indicative of future operating results or future financial conditions:

- *Increase in the sales of lower margin solutions as we expand our operational footprint*. While our current focus remains on expanding our AI driven software application portfolio, opportunities will continue to present themselves to provide those software-based solutions as part of a larger hardware-based turn-key solutions where Airship AI can provide a unique value-add to the customer. While these solutions will positively affect revenue we anticipate our operating profits in future periods may be adversely affected as compared to previous years due to the lower operating margin for hardware versus software applications.

- *Challenges due to geo-political driven supply-chain constraints*. While many of the COVID-19 driven supply chain issues have been resolved, challenges to the timely production and delivery of Taiwan based products we utilize for our edge AI platform due to geo-political factors is a concern looking forward. In the event that our suppliers are unable to provide timely delivery of those supplies it will significantly impact our ability to meet delivery schedules for existing and anticipated edge AI hardware-based solutions.

- *Near-term impacts due to merger and acquisition activity*. If Airship AI merges with or acquires another company, it is reasonably expected that there will be increased operating expenses and costs associated with the merger that could negatively impact operating profits in the future periods immediately following the M&A event. The extent and longevity of those impacts is not possible to quantify.

Segment Reporting

The Financial Accounting Standards Board, or FASB, Accounting Standard Codification, or ASC, Topic 280, *Segment Reporting*, requires that an enterprise report selected information about reportable segments in its financial reports issued to its stockholders. Management monitors the revenue and expense components of the various products and services the Company offers, but operations are managed and financial performance is evaluated on a corporation-wide basis in comparison to a business plan which is developed each year. Accordingly, all operations are considered by management to be one operating segment and one reportable segment as contained in the Consolidated Statements of Operations and Comprehensive Loss to the consolidated financial statements.

Results of Operations

The following table sets forth key components of our results of operations during the three months ended June 30, 2024 and 2023.

(dollars in thousands)

	Three Months Ended June 30,			
	2024	2023	$ Variance	% Variance
Net revenues	$ 6,401	$ 2,770	$ 3,631	131.1%
Cost of net revenues	1,895	1,097	(798)	-72.7%
Gross profit	4,506	1,673	2,833	169.3%
Research and development expenses	703	665	(38)	-5.7%
Selling, general and administrative expenses	2,827	4,092	1,265	30.9%
Total operating expenses	3,530	4,757	1,227	25.8%
Operating income (loss)	976	(3,084)	4,060	131.6%
Other income (expense):				
Gain from change in fair value of warrants	1,542	-	1,542	100.0%
Gain from change in fair value of earnout liability	14,877	-	14,877	100.0%
Gain from change in fair value of convertible debt	1,527	-	1,527	100.0%
Interest expense	(421)	(19)	(402)	-2115.8%
Other expense	(39)	-	(39)	-100.0%
Total other income (expense), net	17,486	(19)	17,505	92131.6%
Income (loss) before income taxes	18,462	(3,103)	21,565	695.0%
Income tax benefit (expense)	-	-	-	-
Net income (loss)	$ 18,462	$ (3,103)	$ 21,565	695.0%

Net Revenues — Net revenues for the three months ended June 30, 2024 increased $3,631,000 to $6,401,000 as compared to $2,770,000 for the three months ended June 30, 2023, as a result of increased product sales. We received purchase orders from various federal government agency customers totaling over $13 million from which we partially shipped in the three months ended June 30, 2024.

Cost of Net Revenues — Cost of net revenues primarily consists of product costs and post customer support. For the three months ended June 30, 2024, cost of sales increased $798,000 to $1,895,000 as compared to $1,097,000 for the three months ended June 30, 2023. The increase was due to higher product sales. Gross profit increased due to product mix, with reduced equipment purchases and increased Outpost AI sales during the three months ended June 30, 2024.

Research and Development Expenses — Research and development expenses for the three months ended June 30, 2024 increased $38,000 to $703,000 as compared to $665,000 for the three months ended June 30, 2023.

Selling, General and Administrative Expenses — Selling, general and administrative expenses for the three months ended June 30, 2024 decreased $1,265,000 to $2,827,000 as compared to $4,092,000 for the three months ended June 30, 2023. The decrease was due to (i) increased insurance costs of $142,000; (ii) increased professional fees of $291,000, primarily related to the merger and the Nasdaq listing; (iii) issuance of common stock for services of $199,000; (iii) increased other operating --expenses of $114,000; and offset by (iv) decreased stock based compensation of $2,011,000. The stock based compensation expense during the three months ended June 30, 2023 included warrants to purchase common stock issued to Victor Huang and Derek Xu on May 8, 2023 for 765,000 shares to each of the founders valued at $2,136,115.

Other Income Expense — Other income for the three months ended June 30, 2024 was $17,486,000 as compared to other expense of $19,000 for the three months ended June 30, 2023. Other expense for the three months ended June 30, 2024 consisted of (i) gain from change in fair value of warrant liability of $1,542,000; (ii) gain from change in fair value of earnout liability of $14,877,000; (iii) gain from change in fair value of convertible debt of $1,527,000; and offset by (iv) interest expense $421,000; and (v) other expense of $39,000.

Other expense for the three months ended June 30, 2023 related primarily to interest and other expense of $19,000.

Net Income— Net income for the three months ended June 30, 2024 was $18,462,000 as compared to net loss of $3,103,000 for the three months ended June 30, 2023. The net income primarily related to noncash items of $16,894,000. Noncash items included (i) stock based compensation of $262,000; (ii) net amortization of operating lease right of use asset of $71,000; (iii) issuance of common stock for services of $198,000; (iv) noncash interest expense of $521,000; (v) gain from change in warrant liability of $1,542,000; (vi) gain from change in earnout liability of $14,877,000; and (vii) gain from change in fair value of convertible note of $1,527,000.

The net loss for the three months ended June 30, 2023 included noncash expenses of $2,775,000 primarily related to $2,136,115 stock compensation expense for warrants issued to founders.

The following table sets forth key components of our results of operations during the six months ended June 30, 2024 and 2023.

(dollars in thousands)

	Six Months Ended June 30,			
	2024	2023	$ Variance	% Variance
Net revenues	$ 16,976	$ 5,709	$ 11,267	197.4%
Cost of net revenues	9,842	3,231	(6,611)	-204.6%
Gross profit	7,134	2,478	4,656	187.9%
Research and development expenses	1,398	1,339	(59)	-4.4%
Selling, general and administrative expenses	6,162	5,925	(237)	-4.0%
Total operating expenses	7,560	7,264	(296)	-4.1%
Operating loss	(426)	(4,786)	4,360	91.1%
Other income (expense):				
Loss from change in fair value of warrants	(5,305)	-	(5,305)	-100.0%
Loss from change in fair value of earnout liability	(6,608)	-	(6,608)	-100.0%
Loss from change in fair value of convertible debt	(512)	-	(512)	-100.0%
Loss on note conversion	(159)	-	(159)	-100.0%
Interest expense	(453)	(19)	(434)	-2284.2%
Other expense	(39)	(10)	(29)	-100.0%
Total other expense, net	(13,076)	(29)	(13,047)	-44989.7%
Loss before income taxes	(13,502)	(4,815)	(8,687)	-180.4%
Income tax benefit (expense)	-	-	-	-
Net loss	$ (13,502)	$ (4,815)	$ (8,687)	-180.4%

Net Revenues — Net revenues for the six months ended June 30, 2024 increased $11,267,000 to $16,976,000 as compared to $5,709,000 to for the six months ended June 30, 2023, as a result of increased product sales. We received purchase orders from various federal government agency customers totaling over $16 million from which we shipped in the six months ended June 30, 2024.

Cost of Net Revenues — Cost of net revenues primarily consists of product costs and post customer support. For the six months ended June 30, 2024, cost of sales increased $6,611,000 to $9,842,000 as compared to $3,231,000 for the six months ended June 30, 2023. The increase was due to higher product sales and product mix with high equipment purchases during the six months ended June 30, 2024.

Research and Development Expenses — Research and development expenses for the six months ended June 30, 2024 increased $59,000 to $1,398,000 as compared to $1,339,000 for the six months ended June 30, 2023.

Selling, General and Administrative Expenses — Selling, general and administrative expenses for the six months ended June 30, 2024 increased $237,000 to $6,162,000 as compared to $5,925,000 for the six months ended June 30, 2023. The increase was due to (i) increased insurance costs of $433,000; (ii) increased professional fees of $768,000, primarily related to the merger and the Nasdaq listing; (iii) issuance of common stock for services of $199,000; (iv) increased subscriptions of $164,000; (v) increased other operating expenses of $77,000; and offset by (vi) decreased stock based compensation of $1,878,000. The stock based compensation during the six months ended June 30, 2023 included warrants to purchase common stock issued to Victor Huang and Derek Xu on May 8, 2023 for 765,000 shares to each of the founders valued at $2,136,115.

Other Expense — Other expense for the six months ended June 30, 2024 was $13,076,000 as compared to other expense of $29,000 for the six months ended June 30, 2023. Other expense for the six months ended June 30, 2024 consisted of (i) loss from change in fair value of warrant liability of $5,305,000; (ii) loss from change in fair value of earnout liability of $6,608,000; (iii) loss from change in fair value of convertible debt of $512,000; (iv) loss on note conversion of $159,000; (v) interest expense of $453,000; and (vi) other interest of $39,000.

Other expense for the six months ended June 30, 2023 related primarily to interest of $19,000 and other expense of $10,000.

Net Loss — Net loss for the six months ended June 30, 2024 was $13,502,000 as compared to net loss of $4,815,000 for the six months ended June 30, 2023. The net loss primarily related to noncash items of $13,987,000. Noncash items included (i) depreciation of $2,000; (ii) stock based compensation of $531,000; (iii) net amortization of operating lease right of use asset of $151,000; (iv) issuance of common stock for services of $198,000; (v) noncash interest expense of $521,000; (vi) loss from change in warrant liability of $5,305,000; (vii) loss from change in earnout liability of $6,608,000; (viii) loss from change in fair value of convertible note of $512,000; and (ix) loss on note conversions of $159,000.

The net loss for the six months ended June 30, 2023 included noncash expenses of $2,775,000 primarily related to $2,136,115 stock compensation expense for warrants issued to founders.

Liquidity and Capital Resources as of June 30, 2024 and December 31, 2023

Liquidity is the ability of a company to generate funds to support its current and future operations, satisfy its obligations, and otherwise operate on an ongoing basis. Significant factors in the management of liquidity are funds generated by operations, levels of accounts receivable and accounts payable and capital expenditures. We formally evaluated our liquidity and cash position most recently in August 2024 when preparing our June 30, 2024 unaudited financial statements. During this process we concluded, based upon existing assets and liabilities, our order backlog and projections, plus the ability to borrow in short term loans from our founder, that we would be able to operate at least for the next twelve months. We have received purchase orders from various federal government agency customers totaling over $16 million from which we shipped and started receiving cash in the first and second quarters of 2024.

As of June 30, 2024, we had cash of approximately $227,000 and accounts receivable of approximately $3,440,000 which we expect to collect in the near term after quarter end. We have incurred losses from operations over the past few years and had an accumulated deficit of $30,979,000 as of June 30, 2024. We also had at June 30, 2024 a working capital deficit of approximately $6,712,000. The net working capital deficit includes a couple of items that are expected to require limited cash outlays in the future, including the current deferred revenue totaling $3,791,970 and convertible debt totaling $2,675,919, which we expect to be converted to equity. We have primarily funded our operations from operating cash, proceeds from debt borrowings and advances from founders.

Operating Activities

Net cash used in operating activities for the six months ended June 30, 2024 was $4,147,000. This amount was primarily related to (i) net loss of $13,502,000; and (ii) net working capital reductions of $4,632,000; offset by (iii) noncash items of $13,987,000. Noncash items included (iv) depreciation of $2,000; (v) stock based compensation of $531,000; (vi) net amortization of operating lease right of use asset of $151,000; (vii) issuance of common stock for services of $198,000; (viii) noncash interest expense of $521,000; (ix) loss from change in warrant liability of $5,305,000; (x) loss from change in earnout liability of $6,608,000; (xi) loss from change in fair value of convertible note of $512,000; and (xii) loss on note conversions of $159,000.

Net cash used in operating activities for the six months ended June 30, 2023 was $737,000. This amount was primarily related to (i) a net loss of $4,815,000; offset by (ii) net working capital increases of $1,303,000; and (iii) noncash charges of $2,775,000. Noncash charges included (iv) depreciation of $7,000; (v) stock based compensation- stock options of $274,000; (vi) stock based compensation- warrants of $2,136,000; and (vii) net amortization of operating lease right of use asset of $358,000.

Financing Activities

Net cash provided by financing activities for the six months ended June 30, 2024 was $1,240,000 and consisted of (i) proceeds from warrant exercise of $293,000; (ii) advances from founders of $800,000; and (iii) proceeds from stock option exercises of $147,000.

Net cash provided by financing activities for the six months ended June 30, 2023 was $2,660,000 and consisted of (i) proceeds from convertible promissory note of $1,985,000; (ii) advances from founders of $1,100,000; and offset by (iii) repayment of small business loan and line of credit of $425,000.

Our contractual cash obligations as of June 30, 2024 (excluding debt financing arrangements below) are summarized in the table below:

Contractual Cash Obligations	Total	1 Year	1-3 Years	4-5 Years
Operating lease cash payments	$ 1,168,865	$ 299,727	$ 740,740	$ 128,398

Debt Financing Arrangements

On June 22, 2023, we entered into a senior secured convertible promissory note with Platinum Capital Partners Inc. and received $2,000,000. As a condition of funding, we paid off three small notes and accounts payable totaling $374,000. At the option of the holder, the note is convertible into cash, common stock or a combination of cash and stock. We expect the convertible debt to be converted to equity. On June 22, 2024, we entered into an Extension Agreement related to the Platinum convertible note. The Extension Agreement extended the due date of the Platinum convertible note from June 22, 2024 to June 22, 2025.

On November 2, 2023, we issued senior secured convertible promissory notes for $600,000 to two private investors. At the option of the holders, the notes are convertible into cash, common stock or a combination of cash and stock. On March 5, 2024, the two private investors converted the debt to equity.

Mr. Huang has committed to providing additional temporary funding if it is necessary.

We believe that our cash on hand, funding from the completion of the merger, results of operations and financing transactions will be sufficient to fund our operations for the next twelve months.

Equity financing, if obtained, could result in dilution to our then-existing stockholders and/or require such stockholders to waive certain rights and preferences. If such financing is not available on satisfactory terms, or is not available at all, we may be required to delay, scale back, or eliminate the development of business opportunities and our operations and financial condition may be materially adversely affected.

Contractual Obligations and Commitments

On July 13, 2023, we entered into a lease in Redmond, WA for 15,567 square feet of office and warehouse space which started October 1, 2023. The monthly payment is $25,000 per month. The lease expires October 31, 2027 and the monthly payment increases 3% on July 31, 2024 and each year thereafter. There is a one three year option to extend based on the fair market rate on October 31, 2027.

On February 29, 2024, we extended a lease in Moorestown, North Carolina. The Company leases 3,621 square feet and the net monthly payment is $6,488. The lease expires on August 29, 2024.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements (as that term is defined in Item 303 of Regulation S-K) that are reasonably likely to have a current or future material effect on our financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with U.S. GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Actual results could differ materially from those estimates due to risks and uncertainties, including uncertainty in the current economic environment. To the extent that there are material differences between these estimates and our actual results, our future consolidated financial statements will be affected.

We believe that the significant accounting policies described in "*Note 2, Summary of Significant Accounting Policies*" to our audited consolidated financial statements are accurate and complete. The critical accounting estimates and policies during the six months ended June 30, 2024 have not materially changed to those discussed in our Annual Report on Form 10-K for the year ended December 31, 2023.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable to smaller reporting companies.

ITEM 4. CONTROLS AND PROCEDURES.

a) Evaluation of Disclosure Controls and Procedures

We conducted an evaluation, under the supervision and with the participation of our management, of the effectiveness of the design and operation of our disclosure controls and procedures. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (“Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures also include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2024, our disclosure controls and procedures are effective at the reasonable assurance level.

b) Inherent Limitations on Internal controls

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate. A control system, no matter how well designed and operated can provide only reasonable, but not absolute, assurance that the control system’s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their cost.

c) Changes in Internal Control over Financial Reporting

During the six months ended June 30, 2024, there were no other changes in our internal controls over financial reporting, which were identified in connection with our management’s evaluation required by paragraph (d) of rules 13a-15 and 15d-15 under the Exchange Act, that materially affected, or is reasonably likely to have a material effect on our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may become involved in actions, claims, litigation, and other legal proceedings occurring in theordinary course of its business from time to time, including assertions by third parties relating to intellectual property infringement, contract or warranty breaches, or employment-related matters. We are not currently a party to any actions, claims, suits, or other legal procedures whose conclusion, if not determined in our favor, would have a major adverse effect on our business, financial condition, or results of operations, either individually or in the aggregate.

ITEM 1A. RISK FACTORS.

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item. Our market risks are similar to those disclosed under the caption "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2023, and our other filings with the SEC.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

During the three months ended June 30, 2024, we had the following sales of unregistered equity securities:

On May 16, 2024, we issued 50,000 shares of common stock to Pamria LLC for consulting and investor relations services. This issuance was made pursuant to the exemption from registration under the Securities Act in reliance on Section 4(a)(2).

On June 22, 2024, we entered into an extension agreement with Platinum Capital Partners, Inc. to extend the maturity date of the Platinum Convertible Note to June 22, 2025. In consideration for entering into the extension agreement, we agreed to issue to Platinum 232,360 shares of common stock. This issuance was made pursuant to the exemption from registration under the Securities Act in reliance on Section 4(a)(2).

In June 2024, we issued an aggregate of 294,448 shares of common stock upon the exercise of stock options at exercise prices ranging from \$0.12 to \$1.64 per share. This issuance was made pursuant to the exemption from registration under the Securities Act in reliance on Section 4(a)(2).

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

Exhibit No.	Description
10.1	Amended and Restated Senior Secured Convertible Promissory Note issued February 2, 2024 by Airship AI Holdings, Inc. to Platinum Capital Partners Inc. (incorporated by reference to Exhibit 10.1 to the registrant’s Current Report on Form 8-K filed with the SEC on February 6, 2024).
10.2	Amended and Restated Security Agreement dated February 2, 2024 between Airship AI Holdings, Inc. and Platinum Capital Partners Inc. (incorporated by reference to Exhibit 10.2 to the registrant’s Current Report on Form 8-K filed with the SEC on February 6, 2024).
10.3	Amended and Restated Guaranty dated February 2, 2024 between Airship AI Holdings, Inc., Platinum Capital Partners Inc. (incorporated by reference to Exhibit 10.3 to the registrant’s Current Report on Form 8-K filed with the SEC on February 6, 2024).
10.4	Amended and Restated Subordination Agreement dated February 2, 2024 between Airship AI Holdings, Inc. and Platinum Capital Partners Inc. (incorporated by reference to Exhibit 10.4 to the registrant’s Current Report on Form 8-K filed with the SEC on February 6, 2024).
10.5	Extension Agreement between Airship AI Holdings, Inc. and Platinum Capital Partners Inc. dated June 22, 2024. (incorporated by reference to Exhibit 10.1 to the registrant’s Current Report on Form 8-K filed with the SEC on June 24, 2024)
31.1	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because iXBRL tags are embedded within the Inline XBRL document).
101.SCH	Inline XBRL Taxonomy Extension Schema Document.
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	Inline XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104	The Cover Page Interactive Data File, formatted in Inline XBRL (included within the Exhibit 101 attachments).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 14, 2024

Airship AI Holdings, Inc.

/s/ Victor Huang
Name: Victor Huang
Title: Chief Executive Officer
(Principal Executive Officer)

/s/ Mark E. Scott
Name: Mark E. Scott
Title: Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO
EXCHANGE ACT RULES 13a-14(a) and 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Victor Huang, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Airship AI Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2024

/s/ Victor Huang
Victor Huang
Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO
EXCHANGE ACT RULES 13a-14(a) and 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mark E. Scott, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Airship AI Holdings, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2024

/s/ Mark E. Scott
Mark E. Scott
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with Quarterly Report of Airship AI Holdings, Inc. (the "Company") on Form 10-Q for the quarterly period ended June 30, 2024 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Victor Huang, Chief Executive Officer (Principal Executive Officer) of the Company, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2024

/s/ Victor Huang
Victor Huang
Chief Executive Officer
(Principal Executive Officer)

A signed original of this written statement required by Section 906 has been provided to Airship AI Holdings, Inc. and will be retained by Airship AI Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

The forgoing certification is being furnished to the Securities and Exchange Commission pursuant to § 18 U.S.C. Section 1350. It is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with Quarterly Report of Airship AI Holdings, Inc. (the “Company”) on Form 10-Q for the quarterly period ended June 30, 2024 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned Mark E. Scott, Chief Financial Officer (Principal Financial and Accounting Officer) of the Company, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2024

/s/ Mark E. Scott
Mark E. Scott
Chief Financial Officer
(Principal Financial and Accounting Officer)

A signed original of this written statement required by Section 906 has been provided to Airship AI Holdings, Inc. and will be retained by Airship AI Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

The forgoing certification is being furnished to the Securities and Exchange Commission pursuant to § 18 U.S.C. Section 1350. It is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.