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**FINANCIAL INFORMATION  
QUARTER-END REPORT  
June 30, 2012**

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## **Section One: Issuers' Continuing Disclosure Obligations**

### **PART A GENERAL COMPANY INFORMATION**

#### **ITEM 1 VIRTRA SYSTEMS, INC.**

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Tempe, AZ 85284**

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**Fax: (480) 968-1448**

**www.virtra.com**

### **PART B SHARE STRUCTURE**

#### **ITEM 2. Shares outstanding**

|  |                    |
|--|--------------------|
| <b>(i) June 30, 2012</b>                                   |                    |
| <b>(ii) Number of shares authorized</b>                    | <b>500,000,000</b> |
| <b>(iii) Total number of shares outstanding</b>            | <b>158,285,045</b> |
| <b>(iv) Freely tradable shares (public float)</b>          | <b>137,004,908</b> |
| <b>(v) Total number of beneficial shareholders</b>         | <b>2,487</b>       |
| <b>(vi) Total number of shareholders of record</b>         | <b>183</b>         |
| <b>(i) December 31, 2011</b>                               |                    |
| <b>(ii) Number of shares authorized</b>                    | <b>500,000,000</b> |
| <b>(iii) Total number of shares issued and outstanding</b> | <b>158,328,245</b> |
| <b>(iv) Freely tradable shares (public float)</b>          | <b>137,004,908</b> |
| <b>(v) Total number of beneficial shareholders</b>         | <b>2,487</b>       |
| <b>(vi) Total number of shareholders of record</b>         | <b>183</b>         |

**PART C FINANCIAL INFORMATION**

**ITEM 3. Interim Financial Statements**

**VIRTRA SYSTEMS INC.  
Balance Sheets as of June 30, 2012 and December 31, 2011**

|   | <u>6/30/2012</u><br><u>(unaudited)</u> | <u>12/31/2011</u><br><u>(audited)</u> |
|---|--|---------------------------------------|
| <b>Assets</b>   |  |                                       |
| Current assets:   |  |                                       |
| Cash and cash equivalents.....  | 522,802                                | \$ 144,051                            |
| Accounts receivable, net.....   | 419,818                                | 365,720                               |
| Inventory.....  | 588,366                                | 804,548                               |
| Prepaid expenses and other current assets.....  | 134,824                                | 157,180                               |
|   | <hr/>                                  | <hr/>                                 |
| Total current assets.....   | 1,665,810                              | 1,471,499                             |
| Property and equipment, net.....  | 657,996                                | 799,189                               |
|   | <hr/>                                  | <hr/>                                 |
| Total assets.....   | <u>\$ 2,323,806</u>                    | <u>\$ 2,270,688</u>                   |
| <b>Liabilities and Stockholders' Equity/(Deficit)</b>   |  |                                       |
| Current liabilities:  |  |                                       |
| Accounts payable.....   | \$ 268,079                             | \$ 271,734                            |
| Accounts payable - related party.....   | 11,894                                 | 35,048                                |
| Accrued compensation and related costs.....   | 307,207                                | 292,028                               |
| Accrued expenses and other current liabilities.....   | 133,912                                | 131,437                               |
| Borrowing on line of credit.....  | 610,000                                | -                                     |
| Deferred revenue.....   | 526,301                                | 1,987,162                             |
|   | <hr/>                                  | <hr/>                                 |
| Total current liabilities.....  | 1,857,393                              | 2,717,409                             |
| Accrued rent liability - long-term.....   | 130,614                                | 114,023                               |
|   | <hr/>                                  | <hr/>                                 |
| Total liabilities.....  | 1,988,007                              | 2,831,432                             |
| Commitments and contingencies   |  |                                       |
| Stockholders' equity/(deficit):   |  |                                       |
| Preferred stock \$0.005 par value; 2,000,000 shares authorized;<br>no shares issued or outstanding as of December 31, 2011.....                             | -                                      | -                                     |
| Common stock \$0.005 par value; 500,000,000 shares authorized; 158,328,245<br>shares issued and 158,285,045 shares outstanding as of December 31, 2011..... | 791,641                                | 791,641                               |
| Additional paid-in capital.....   | 12,954,640                             | 12,912,365                            |
| Treasury stock, at cost (43,200 common shares).....   | (2,981)                                | (2,981)                               |
| Accumulated deficit.....  | (13,407,501)                           | (14,261,769)                          |
|   | <hr/>                                  | <hr/>                                 |
| Total stockholders' equity/(deficit).....   | 335,799                                | (560,744)                             |
|   | <hr/>                                  | <hr/>                                 |
| Total liabilities and stockholders' equity/(deficit).....   | <u>\$ 2,323,806</u>                    | <u>\$ 2,270,688</u>                   |

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

**VIRTRA SYSTEMS, INC.**

**Statements of Operations for the three months ended June 30, 2012 and for the 6 months ended June 30, 2012**

|   | <b>Three months<br/>ended<br/>6/30/2012<br/>(unaudited)</b> | <b>Six months<br/>ended<br/>6/30/2012<br/>(unaudited)</b> |
|---|---|---|
| Net revenue.....  | \$ 2,932,147  | \$ 5,540,792  |
| Cost of products sold.....  | <u>917,933</u>  | <u>1,750,894</u>  |
| Gross margin.....   | 2,014,214   | 3,789,898   |
| General and administrative expenses.....                                | <u>1,403,912</u>  | <u>2,933,336</u>  |
| Income from operations.....   | 610,302   | 856,562   |
| Other income.....   | 852   | 1,037   |
| Other expense.....  | <u>(2,921)</u>  | <u>(3,330)</u>  |
| Net income.....   | <u><u>\$ 608,233</u></u>                                    | <u><u>\$ 854,269</u></u>                                  |
|   |   |   |
| Weighted average of shares outstanding<br>-basic and fully diluted..... | 158,285,045   | 158,285,045   |
| Net Income per share<br>-basic and fully diluted.....                   | \$ 0.00   | \$ 0.01   |

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

**VIRTRA SYSTEMS, INC.**

**Statement of Stockholders' Equity for the six months ended June 30, 2012**  
(Unaudited)

|   | <u>Common stock</u> |                   | <u>Additional<br/>paid in capital</u> | <u>Treasury<br/>Stock</u> | <u>Accumulated<br/>Deficit</u> | <u>Total</u>      |
|---|---------------------|-------------------|---------------------------------------|---------------------------|--------------------------------|-------------------|
|   | <u>Shares</u>       | <u>Amount</u>     |                                       |                           |                                |                   |
| Balance at January 1, 2012,<br>as restated..... | 158,285,045         | 791,641           | 12,912,365                            | (2,981)                   | (14,261,769)                   | (560,744)         |
| Net Income.....                                 | -                   | -                 | -                                     | -                         | 854,269                        | 854,269           |
| Stock compensation expense.....                 | -                   | -                 | 42,275                                | -                         | -                              | 42,275            |
| Treasury Stock purchase.....                    | -                   | -                 | -                                     | -                         | -                              | -                 |
| Balance at June 30, 2012.....                   | <u>158,285,045</u>  | <u>\$ 791,641</u> | <u>\$ 12,954,640</u>                  | <u>\$(2,981)</u>          | <u>\$(13,407,500)</u>          | <u>\$ 335,800</u> |

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

**VIRTRA SYSTEMS, INC.**

**Statements of Cash Flows for the six months ended June 30, 2012 and for the 12 months ended December 31, 2011**

|  | <b>Six months<br/>ended<br/>6/30/2012<br/>(unaudited)</b> | <b>Twelve months<br/>ended<br/>12/31/2011<br/>(audited)</b> |
|--|---|---|
| Cash flows from operating activities:  |   |   |
| Net income/(loss).....   | \$ 854,269  | \$ (692,761)  |
| Adjustments to reconcile net income/(loss) to net cash<br>used in operating activities |   |   |
| Depreciation and amortization.....   | 154,596   | 202,686   |
| Stock-based compensation.....  | 42,275  | 115,512   |
| Changes in operating assets and liabilities:   |   |   |
| Accounts receivable.....   | (54,098)  | (51,654)  |
| Inventory.....   | 216,182   | 197,073   |
| Prepaid expenses and other assets.....   | 22,356  | (97,227)  |
| Accounts payable and other accrued expenses.....                                       | 30,590  | 94,313  |
| Deferred revenue.....  | (1,460,861)   | 131,295   |
| Due to related parties.....  | (23,154)  | (118)   |
| Net cash used in operating activities.....   | <u>(217,845)</u>  | <u>(100,881)</u>  |
| Cash flows from investing activities:  |   |   |
| Purchase of property and equipment.....  | <u>(13,404)</u>   | <u>(292,995)</u>  |
| Net cash used in investing activities.....   | <u>(13,404)</u>   | <u>(292,995)</u>  |
| Cash flows from financing activities:  |   |   |
| Draws on line of credit.....   | 710,000   | 750,000   |
| Repayments of line of credit.....  | (100,000)   | (750,000)   |
| Purchase of treasury stock.....  | <u>-</u>  | <u>(2,981)</u>  |
| Net cash provided by/(used in) financing activities.....                               | <u>610,000</u>  | <u>(2,981)</u>  |
| Increase/(decrease) in cash and cash equivalents.....                                  | 378,751   | (396,857)   |
| Cash and cash equivalents, beginning of period.....                                    | <u>144,051</u>  | <u>540,908</u>  |
| Cash and cash equivalents, end of period.....  | <u>\$ 522,802</u>   | <u>\$ 144,051</u>   |
| Cash paid during the period for:   |   |   |
| Interest.....  | <u>\$ 2,035</u>   | <u>\$ 3,200</u>   |
| Taxes.....   | <u>\$ -</u>   | <u>\$ -</u>   |

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

**VIRTRA SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**(unaudited)**

**1. Significant Accounting Policies**

***Basis of Presentation***

The accompanying un-audited interim financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America (“GAAP”) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and the results of operations for the interim period presented have been included. Operating results for the interim period are not necessarily indicative of the results that may be expected for the respective full year. All transactions are denominated in US dollars.

The Company’s financial statements as of December 31, 2011 and for the period ending December 31, 2011 are audited. See the previously disclosed VirTra’s 2011 Annual Report for complete footnotes.

***Liquidity***

The accompanying financial statements have been prepared on a going concern basis, which assumes the Company will be able to meet its obligations and continue its operations for at least the next twelve months. Such assumption contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred a loss for the year ended December 31, 2011 and has a working capital deficit of approximately \$1.25 million and an accumulated deficit of approximately \$14.3 million as of December 31, 2011. For the six months ending June 30, 2012 the Company had a gain and reduced its working capital deficit to approximately \$0.19 million and accumulated deficit to approximately \$13.4 million. These deficits raise doubt about the Company’s ability to continue as a going concern. As a result, realization values of the Company’s assets and liabilities may be substantially different from reported carrying values and these financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should we be unable to continue as a going concern. The report from our independent registered public accounting firm includes language related to these uncertainties.

The Company’s continuation as a going concern is dependent upon its ability to generate sufficient cash flow from sales to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability. Potential sources of cash include new contracts, external debt, the sale of shares of Company stock or alternative methods such as mergers or sale transactions. No assurances can be given, however, that the Company will be able to obtain any of these potential sources of cash. Furthermore, the Company may be unable to raise additional capital on commercially acceptable terms, if at all, and if the Company raises capital through additional equity financings, existing shareholders may have their ownership interests diluted.

***Management’s Estimates and Assumptions***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements. Management considers VirTra’s most significant accounting estimates to include valuation assumptions for share-based payments, allowance for doubtful accounts receivable, inventory reserves, accrual for warranty reserves, the carrying value of long-lived assets, income tax valuation allowances and capitalization of labor and overhead to inventory for work in progress. Actual results could differ significantly from those estimates.

***Fair Value of Financial Instruments***

The fair value of financial instruments approximates their carrying values at period end dates due to their short maturities. These financial instruments consist of cash and cash equivalents, accounts receivable and accounts payable.

***Cash and Cash Equivalents***

The Company considers all highly liquid investments purchased with an initial maturity of 90 days or less to be cash equivalents.

***Accounts Receivable and Allowance for Doubtful Accounts***

The Company recognizes an allowance for losses on accounts receivable based on an analysis of historical bad debt experience, current receivables aging, and expected future write-offs, as well as an assessment of specific identifiable customer accounts considered at risk or uncollectible. As of June 30, 2012, management has determined all receivable balances to be fully collectible and accordingly, no allowance was recognized at such time. Accounts receivable are non-interest bearing and are generally unsecured.



***Inventories***

Inventories are stated at the lower of cost or market with cost being determined on the first-in, first-out method. Work in progress and finished goods inventory includes an allocation for capitalized labor and overhead. The Company routinely evaluates the carrying value of inventories and provides reserves when appropriate to reduce inventories to the lower of cost or market to reflect estimated net realizable value. As of June 30, 2012, management has determined all inventory is salable at prices greater than cost and accordingly, no reserve has been recognized at June 30, 2012.

***Property and Equipment***

Property and equipment are carried at depreciated cost. Gains or losses related to retirements or disposition of fixed assets are recognized in operations in the period incurred. Costs of normal repairs and maintenance are charged to expense as incurred, while betterments or renewals are capitalized. Depreciation commences at the time the assets are placed in service. Depreciation is provided using the straight-line method over the estimated economic lives of the assets or for leasehold improvements, over the shorter of the estimated useful life or the lease term, which are summarized as follows:

|                                     |             |
|-------------------------------------|-------------|
| Computer equipment.....             | 3 - 5 years |
| Furniture and office equipment..... | 5 - 7 years |
| Leasehold improvements.....         | 7 years     |

***Revenue Recognition, Deferred Revenue and Change in Accounting Principle***

Net revenues include sales of products and services. Product sales consist of simulators, upgrade components, recoil kits, Threat-Fire™ and other accessories. Services include limited warranties and related support. The Company recognizes revenue for these products and services when it is realized or realizable and earned. Revenue is considered realized and earned when: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred and/or services have been rendered; (iii) the price is fixed and determinable; and (iv) collection of the resulting receivable is reasonably assured. Shipping fees are charged to customers and recorded as a component of net sales.

***Products***

Revenue from the sale of products is recognized when title and risk of loss passes to the customer. Delivery is considered complete when products have been shipped to the customer, title and risk of loss has transferred to the customer and customer acceptance has been satisfied. For customers other than United States federal agencies, the Company generally requires deposits in advance of shipment for customer sales orders. Customer deposits are recorded as a current liability under deferred revenue on the accompanying balance sheet and totaled \$267,328 as of June 30, 2012.

***Services***

Services include separately priced extended limited warranties on parts and labor, and technical support. Revenue is recognized for service contracts as earned, which is generally on a straight-line basis over the term of the contract. The Company does warranty its products from manufacturing defects on a limited basis for a period of one year after purchase, but also sells separately priced extended warranties for periods of up to four years after the expiration of the standard one year warranty. After the one year standard warranty expires and during the term of the extended warranty, if the device fails to operate properly from defects in materials and workmanship, the Company will fix or replace the defective product. Deferred revenue for separately priced extended warranties totaled \$258,973 as of June 30, 2012.

***Change in Accounting Principle***

During the fourth quarter ended December 31, 2011, the Company changed its method of simulator revenue recognition from the percentage-of-completion method of accounting to recognizing revenue upon delivery and acceptance of the product. The Company believes that this is a preferred method of recognizing revenue as: (i) revenue is recognized only after the customer has received and accepted the simulator; and (ii) this method better aligns the recognition of revenue to the four criteria outlined above.

***Cost of products sold***

Cost of products sold represents manufacturing costs, consisting of materials, labor and overhead related to finished goods and components. Shipping costs incurred related to product delivery are included in cost of products sold.

***Advertising Costs***

Costs associated with advertising are expensed as incurred. Advertising expenses include domestic and international tradeshows, website, and sales promotional materials.

### ***Research and Development Costs***

Research and development costs are expensed as incurred. Research and development costs primarily include expenses directly related to research and development support.

### ***Concentration of Credit Risk and Major Customers and Suppliers***

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and accounts receivable. The Company's cash and cash equivalents are maintained with financial institutions with high credit standings. Sales are typically made on credit and the Company generally does not require collateral. Management performs ongoing credit evaluations of its customers' financial condition and maintains an allowance for estimated losses. Historically, the Company has experienced minimal charges relative to doubtful accounts.

The Company sells its products primarily to federal and state agencies in the United States.

The Company currently purchases small machined parts, custom cartridge assemblies and electronic components from suppliers located in the United States. Although the Company currently obtains many of these components from single source suppliers, the Company could seek to have the parts, customer cartridges and electronic components manufactured elsewhere. As a result, management believes it could obtain alternative suppliers in most cases without incurring significant production delays. The Company acquires its components on a purchase order basis and does not have long-term contracts with suppliers.

### ***Income Taxes***

Deferred tax assets and liabilities are recorded based on the difference between the financial statement and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company calculates a provision for income taxes using the asset and liability method, under which deferred tax assets and liabilities are recognized by identifying the temporary differences arising from the different treatment of items for tax and accounting purposes. In determining the future tax consequences of events that have been recognized in the financial statements or tax returns, judgment and interpretation of statutes are required.

In assessing the realizability of deferred tax assets, management assesses the likelihood that deferred tax assets will be recovered from future taxable income, and to the extent that recovery is not likely or there is insufficient operating history, a valuation allowance is established. The Company adjusts the valuation allowance in the period management determines it is more likely than not that net deferred tax assets will or will not be realized. As of December 31, 2011, the Company has provided a valuation allowance for all net deferred tax assets due to a history of operating losses.

As of December 31, 2011, the Company did not recognize any assets or liabilities relative to uncertain tax positions, nor does the Company anticipate any significant unrecognized tax benefits will be recorded during 2012. Interest or penalties, if any, will be recognized in income tax expense. Since there are no significant unrecognized tax benefits as a result of tax positions taken, there are no accrued penalties or interest. Tax positions are positions taken in a previously filed tax return or positions expected to be taken in a future tax return that are reflected in measuring current or deferred income tax assets and liabilities reported in the financial statements. Tax positions include, but are not limited to, the following:

- an allocation or shift of income between taxing jurisdictions;
- the characterization of income or a decision to exclude reportable taxable income in a tax return; or
- a decision to classify a transaction, entity or other position in a tax return as tax exempt.

The Company reflects tax benefits only if it is more likely than not that the Company will be able to sustain the tax return position, based on its technical merits. If a tax benefit meets this criterion, it is measured and recognized based on the largest amount of benefit that is cumulatively greater than 50% likely to be realized.

The Company is potentially subject to tax audits for its United States federal and Arizona state income tax returns for tax years ended 2009 to 2011 and 2008 to 2011, respectively; however, earlier years may be subject to audit under certain circumstances. Tax audits by their very nature are often complex and can require several years to complete.

### ***Impairment of Long-lived Assets***

Long lived assets, such as equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Fair value is determined based on

discounted cash flows or appraised values, depending on the nature of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount of fair value less costs to sell, and are no longer depreciated.

**Stock Based Compensation**

The Company calculates the fair value of stock-based awards using the Black-Scholes-Merton option pricing valuation model, which incorporates various assumptions including volatility, expected term and risk-free interest rates. The assumptions used for the period ended June 30, 2012, and the resulting estimates of weighted-average fair value per share of options granted during those periods, are as follows:

|   |             |
|---|-------------|
| Volatility.....                                     | 94% to 119% |
| Risk-free interest rate.....                        | 2% to 3%    |
| Dividend rate.....                                  | -           |
| Expected term.....                                  | 7 years     |
| Weighted average fair value of options granted..... | \$ 0.05     |

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on historical volatility of the Company’s stock. The risk-free interest rate is based on the implied yield available on United States Treasury zero-coupon issues with an equivalent remaining term. The Company has not paid dividends in the past and does not plan to pay any dividends in the near future. The estimated fair value of stock-based compensation awards and other options is amortized to expense on a straight line basis over the relevant vesting period. As share-based compensation expense recognized is based on awards ultimately expected to vest, it is reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company’s forfeiture rate was calculated based on its historical experience of awards which ultimately vested.

**Net Income per Common Share**

The net income per common share is computed by dividing net income by the weighted average of common shares outstanding.

**New Accounting Pronouncements**

With the exception of those discussed below, no recent accounting pronouncements or changes in accounting pronouncements during the year ended December 31, 2011 are of significance or potential significance to us.

In May 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2011-04 (ASU No. 2011-04) “Fair Value Measurement”. Requirements of ASU No. 2011-04 amends Topic 820 in two ways. Specifically, some of the amendments clarify how to apply the existing fair value measurement and disclosure requirements, while some of the amendments change a particular principle or requirement for measuring fair value or disclosing information about fair value measurements. ASU No. 2011-04 does not extend the use of fair value accounting, but rather provides guidance on how it should be applied where its use is already required or permitted by other standards within GAAP. ASU No. 2011-04 supersedes much of the guidance in ASC Topic 820, but also clarifies existing guidance and changes certain wording in order to align ASC Topic 820 with international standards. The effective date for ASU 2011-04 is for interim and annual periods beginning after December 15, 2011, and should be applied prospectively. The Company’s adoption of this policy is not expected to have a material effect on the Company’s financial statements.

In June 2011, the FASB issued guidance to require presentation of the total of comprehensive income, the components of net income and the components of other comprehensive income (“OCI”) either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders’ equity. Regardless of which format is chosen, the amendments establish a requirement for entities to present on the face of the financial statements reclassification adjustments for items that are reclassified from OCI to net income in the statement(s) where the components of net income and the components of OCI are presented. This guidance was effective for the Company on January 1, 2012; however, during December 2011 the FASB issued ASU No. 2011-12, which defers those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. The Company’s adoption of this policy is not expected to have a material effect on the Company’s financial statements.

## 2. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following:

|   | as of 6/30/12<br>(unaudited) | as of 12/31/11<br>(audited) |
|---|------------------------------|-----------------------------|
| Standard one-year manufacturer's warranty.....            | \$ 40,000                    | \$ 40,000                   |
| State and local taxes.....                                | 74,014                       | 62,069                      |
| Insurance premiums payable.....                           | 4,898                        | 14,368                      |
| Other.....  | 15,000                       | 15,000                      |
| Total accrued expenses and other current liabilities..... | <u>\$ 133,912</u>            | <u>\$ 131,437</u>           |

## 3. Related Party Transactions

The Company reimburses its executive officers for business expenses charged to personal credit cards. The Company makes monthly payments directly to the card issuer for these business expenses incurred on behalf of the Company.

## 4. Commitments and Contingencies

### *Operating Lease Obligations*

The Company's operating lease obligations primarily relate to a facility lease for the Company's corporate office space located at 7970 South Kyrene Road, Tempe, Arizona 85284. Future minimum lease payments under non-cancelable operating leases are as follows (years ended December 31):

|            |                     |
|------------|---------------------|
| 2012.....  | \$ 210,528          |
| 2013.....  | 226,374             |
| 2014.....  | 271,649             |
| 2015.....  | 316,923             |
| Total..... | <u>\$ 1,025,474</u> |

The Company has recognized a liability of \$130,614 as of June 30, 2012 relative to the increasing future minimum lease payments in the above table. Rent expense was \$150,412 for the quarter ended June 30, 2012.

### *General or Threatened Litigation*

From time to time, the Company is notified of threatened litigation or that a claim is being made against it. The Company's policy is to not disclose the specifics of any claim or threatened lawsuit until such complaint is actually served on the Company. After consultation with appropriate legal counsel, if it is determined that the Company is not at fault, the Company will defend itself accordingly. Although we do not expect the outcome in any pending individual case to be material, the outcome of any litigation is inherently uncertain and there can be no assurance that any expense, liability or damages that may ultimately result from the resolution of these matters will be covered by our insurance or will not be in excess of amounts provided by insurance coverage and will not have a material adverse effect on our business, operating results or financial condition. As of June 30, 2012 the Company has no accrual for general or threatened litigation and the Company believes its exposure to be de minimis in nature.

### *Employment Agreements*

On April 2, 2012, the Company entered into three-year Employment Agreements with its Chief Executive Officer and Chief Operating Officer that call for base annual salaries of \$195,000 and \$175,000, respectively, subject to cost of living adjustments, and contain automatic one-year extension provisions. Capitalized terms in this note are defined in the Employment Agreements. If the Company's Chief Executive Officer or Chief Operating Officer are terminated by the Company for any reason other than for Cause, or if the Executive voluntarily terminates his own employment for Good Reason but not including a Change in Control, then the Company shall, subject to the terms of the Employment Agreements, be obligated to pay the Executive an amount equal to the product of (i) the greater of (a) the Executive's annual base salary in effect on the day preceding the date of such termination or (b) the Executive's annual base salary during the twelve full calendar months preceding the date of such termination, times (ii) three. This payment shall be payable in 18 equal monthly payments commencing on the first day of the month following the month in which the termination occurs. If a Change of Control of the Company occurs while the Executive is an employee of the Company and within 36 months from the date of such Change in Control the Company terminates the Executive's employment for any reason (except for the death or Disability of the Executive or for Cause) or the Executive terminates his employment for any reason, then the Company shall, subject to

certain limitations, pay the Executive any earned and accrued but unpaid base salary through the date of termination plus an amount of severance pay equal to the product of (i) the greater of (a) the Executive's annual base salary in effect on the day preceding the date on which the Change of Control occurred or (b) the Executive's annual base salary during the twelve full calendar months preceding the date on which the Change of Control occurred, times (ii) four.

## **5. Line of Credit**

The Company has a line of credit agreement with a financial institution with maximum availability of \$750,000. The line of credit is secured by the Company's eligible accounts receivable and inventory and bears interest at varying rates, which at June 30, 2012 and December 31, 2011 was prime plus 1.5%, with a floor of 5.0%. Interest expense was \$2,035 for the quarter ended June 30, 2012. The effective rate of interest for the year was 5.0%. The line of credit, which was amended and renewed in October 2011, primarily to increase the borrowing base, matures in October 2012, and requires monthly payments of interest only. The line of credit is co-signed by the Company's Chief Executive Officer and his spouse as guarantors. As of June 30, 2012, \$610,000 was outstanding under the line of credit.

## **6. Stockholders' Deficit**

### *Authorized Capital*

The Company has authorized the issuance of two classes of stock designated as "common stock" and "preferred stock," each having a par value of \$0.005 per share. The Company is authorized to issue 500,000,000 shares of common stock and 2,000,000 shares of preferred stock.

### *Treasury Stock*

In October 2011 the Company repurchased 43,200 restricted common shares from certain shareholders at an average price of \$0.069 per share for a total purchase price \$2,981, which is reflected as treasury stock on the accompanying balance sheet.

### *Stock Options*

The Company periodically issues non-qualified incentive stock options to key employees, officers and directors under a plan approved by the Board of Directors in 2009. Terms of option grants are at the discretion of the Board of Directors. The Board of Directors has also approved a quarterly grant of 50,000 stock options to each of the Company's three directors, with an additional 100,000 stock options for the Chief Executive Officer and an additional 50,000 stock options for the Secretary of the Company. Subsequent to December 31, 2011, the Board of Directors changed the quarterly grant to a total of 100,000 stock options per quarter to the CEO, 75,000 stock options per quarter to the COO/Secretary, and 50,000 stock options per quarter to any board member not an employee of the Company.

## **7. Subsequent Events**

The Company evaluated subsequent events through the date the accompanying financial statements were issued, which was August 5, 2012. Subsequent to December 31, 2011, the Company issued stock options to certain employees for the purchase of a maximum of 4,300,000 common shares, and these options vest over a period of three to five years. The options have strike prices of \$0.05 to \$0.07 per share, an estimated fair value of \$195,508 and have a contractual term of seven years. As previously stated, the Board of Directors changed the quarterly Board of Directors grant to a total of 100,000 stock options per quarter to the CEO, 75,000 stock options per quarter to the COO/Secretary, and 50,000 stock options per quarter to any board member not an employee.

The Company received in July 2012 a type 10 Federal Firearms License from the United States Government.

## **ITEM 4. Management's discussion and Analysis or Plan of Operation.**

### **A. Plan of Operation.**

VirTra Systems plans to operate the Company on a sustainable financial basis. Investments made in 2011 have laid the foundation for the expected growth of the Company. In 2012, the Company plans to continue to invest in research and development as well as sales and marketing. There are no current plans to make significant equipment purchases or to expect significant changes in the number of employees. The Company's going concern, as stated in the December 31, 2011 footnotes to the financial statements, is dependent upon its ability to generate sufficient cash flow from sales to meet its obligations on a timely basis, to obtain additional financing as may be required, and ultimately to attain profitability. Potential sources of cash include new contracts, external debt, the sale of shares of Company stock or alternative methods such as mergers or sale transactions. No assurances can be given, however, that the Company will be able to obtain any of these potential sources of cash. Furthermore, the Company may be unable to raise additional capital on commercially acceptable terms, if at all, and if the Company raises capital through additional equity financings, existing shareholders may have their ownership interests diluted.

### **B. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

VirTra reported gross revenue of \$2.93 million and a net profit of \$0.61 million for the second quarter of 2012. For the first two quarters 2012 (unaudited) both the prorated gross revenue and the net profit were improved as compared with VirTra's 2011 annual results (audited). One customer represented a significant portion of second quarter revenue with \$1 million recognized and corresponding reduction in deferred revenue.

Cost of goods sold for the second quarter was \$.92 million representing a 69% gross profit margin which is an increase as compared with 2011 annual results of 52% gross profit margin. VirTra's profit margin does fluctuate from quarter-to-quarter and is influenced by several factors such as: revenue recognition, volume, vendor pricing, improved production methods, composition of customer orders, and international orders as well as other factors.

VirTra's general and administrative expenses for the second quarter 2012 were \$1.4 million. This represented investment into support and scenarios for current customers. In addition, this includes development work for new products, software and simulator content as well as targeted sales and marketing efforts to attract new customers and distributors in various market segments.

## **ITEM 5. Legal Proceedings**

As of June 30, 2012, the Company has no accrual for general or threatened litigation and the Company believes its exposure to be de minimis in nature.

## **ITEM 6. Default upon Senior Securities**

There has been no material default in the payment of principal, interest, sinking fund installment, or any other material default not cured within 30 days, with respect to any indebtedness of the issuer.

## **ITEM 7. Other Information**

### ***Previously Issued Financial Statements***

During the fourth quarter ended December 31, 2011, VirTra Systems changed its method of simulator revenue recognition from the percentage-of-completion method of accounting to recognizing revenue upon delivery and acceptance of the product. This change has been reflected in the statement of operations effective January 1, 2011 under Item XII. Previously posted financial statements are not comparable with the December 31, 2011 audited financial statements because of the change in accounting principle.

***Departure of Controller***

On March 30, 2012 VirTra accepted the resignation of the corporate controller. Agreeing to mutually part ways, the controller's leaving VirTra was not due to any disagreement between the Company and its management regarding any matter related to the Company's current accounting policies. This required the company to undergo a process over a 45 day period to locate and interview experienced financial and accounting individuals. Ultimately this led to the hiring of the company's current director of finance, corporate controller on May 16, 2012.

**ITEM 8. Exhibits**

There are no exhibits that are required which have not already been described or attached in any prior disclosure statement.

**ITEM 9. Certification of Chief Executive Officer.**

I, Robert D. Ferris, certify that:

1. I have reviewed this Quarterly Disclosure Statement of VirTra Systems, Inc.;
2. Based on my knowledge, this Disclosure Statement 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 statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the Financial Statements and other financial information included or incorporated by reference in this Disclosure Statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: August 6, 2012

/s/ Robert D. Ferris

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CEO/Chairman