Armour Residential REIT, Inc.
Form 424B4
November 04, 2010

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Registration No. 333-169395

Prospectus

4,000,000 Shares

Common Stock

We are selling 4,000,000 shares of common stock.

Our common stock and warrants are currently traded on the NYSE Amex, LLC, or NYSE Amex, under the symbols ARR and ARR.WS respectively. The closing price of our common stock on the NYSE Amex on November 3, 2010 was $7.32 per share.

The underwriters have a 45-day option to purchase a maximum of 600,000 additional shares to cover over-allotments of shares, if any.

Certain of our officers, directors and employees may participate in this offering on the same terms as the public.

We have elected to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes, commencing with our taxable year ended December 31, 2009. To assist us in qualifying as a REIT, among other purposes, stockholders are generally restricted under our charter from beneficially owning more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock. In addition, our charter contains various other restrictions on the ownership and transfer of our common stock. See *Description of Securities Restrictions on Ownership and Transfer.*

Investing in our common stock involves risks. See Risk Factors on page 8.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Price to Public	Underwriting Discounts and Commissions	Proceeds to Us [(1)]
Per Share	$ 7.25	$ 0.36	$ 6.875
Total	$ 29,000,000	$ 1,450,000	$ 27,550,000

(1) Before deducting approximately $350,000 in expenses payable by us

We are offering the shares of common stock for sale on a firm commitment basis. Ladenburg Thalmann & Co. Inc., the representative of the underwriters in this offering, expects to deliver the shares of common stock to investors in the offering on or about November 9, 2010.

Ladenburg Thalmann & Co. Inc.
Lead Bookrunning Manager

Macquarie Capital **Maxim Group LLC**

Co-Bookrunning Managers

National Securities Corporation **Boenning & Scattergood Inc.**

The date of this prospectus is November 4, 2010.

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You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. This documentmay only be used where it is legal to sell these securities. The information in this documentmay only be accurate on the date of this document.

PROSPECTUS SUMMARY

This summary highlights the material information contained in this prospectus. It does not contain all of the information that you should consider before investing in our common stock. You should read carefully the more detailed information set forth under Risk Factors and the other information included in this prospectus. Except where the context suggests otherwise, references to we , us , ARMOUR or the Company are to ARMOUR Residential REIT, Inc. Except as otherwise indicated, the information in this prospectus assumes no exercise of the underwriters' overallotment option.

Overview

We are a Maryland corporation that has elected to be a real estate investment trust, or REIT, for U.S. federal income tax purposes, commencing with our fiscal year ended December 31, 2009. We are externally managed by ARMOUR Residential Management LLC, or ARRM, an entity affiliated with our executive officers. We invest primarily in hybrid adjustable rate, adjustable rate and fixed rate residential mortgage-backed securities, or RMBS, issued or guaranteed by U.S. Government-chartered entities, which we refer to as Agency Securities. The entities issuing or guaranteeing the Agency Securities include:

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the Federal National Mortgage Association, commonly known as Fannie Mae;

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the Federal Home Loan Mortgage Corporation, commonly known as Freddie Mac; and

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the Government National Mortgage Administration, commonly known as Ginnie Mae.

From time to time, a portion of our portfolio may be invested in unsecured notes and bonds issued by U.S. Government-chartered entities, which we refer to as Agency Debt. Agency Debt includes:

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U.S. Treasuries; and

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money market instruments.

We seek attractive long-term investment returns by investing our equity capital and borrowed funds in our targeted asset class. We earn returns on the spread between the yield on our assets and our costs, including the interest cost of the funds we borrow, after giving effect to our hedges.

When acquiring Agency Securities, we typically finance our acquisitions with borrowings under a series of short-term repurchase agreements at the most competitive interest rates available to us and then cost-effectively mitigate our

interest rate and other risks based on our entire portfolio of assets, liabilities and derivatives and our management's view of the market. Successful implementation of this approach requires us to address and effectively mitigate interest rate risk and maintain adequate liquidity.

Follow-On Public Offering

On June 21, 2010, we completed an underwritten follow-on public offering of 5,110,000 shares of common stock at a price of $6.75 per share. The net proceeds to us were approximately $31.9 million, net of approximately $2.6 million in expenses. We actively worked to deploy the proceeds from our follow-on public offering. As of June 30, 2010:

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We invested all of the net proceeds from our follow-on public offering as well as monies that we borrowed under repurchase agreements to increase our investment portfolio to approximately $477.6 million of Agency Securities.

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We borrowed an aggregate of approximately $334.7 million (an increase from year end of $288.3 million) under our master repurchase agreements at a weighted average rate of 0.30% through an expanded group of seven investment banking firms and other lenders to achieve our targeted range of leverage ratios.

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We entered into hedging transactions through Eurodollar futures for a notional amount of approximately $165.0 million, increasing our holdings to 1,990 individual futures contracts. The contracts are designed to mitigate the effects of increases in interest rates under a portion of our repurchase agreements.

Our Manager

We are externally managed by ARRM, a Delaware limited liability company, pursuant to a management agreement between us and ARRM. As an externally-managed company, we depend on the diligence, experience and skill of ARRM for the selection, acquisition, structuring, interest rate risk mitigation and monitoring of our Agency Securities, Agency Debt and associated borrowings. We do not have any employees whom we compensate directly with salaries or other compensation. ARRM currently has five full-time employees.

The management agreement requires ARRM to manage our business affairs in conformity with certain restrictions contained therein, including any material operating policies adopted by us. ARRM's role as manager is subject to the direction and oversight of our board of directors.   ARRM is responsible for:

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advising us with respect to, arranging for, and managing the acquisition, financing, management and disposition of, our investments;

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evaluating the duration and prepayment risk of our investments and arranging borrowing and interest rate risk mitigation strategies; and

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coordinating our capital raising activities.

In conducting these activities, ARRM also advises us on the formulation of, and implements, our operating strategies and policies, arranges for our acquisition of assets, monitors the performance of our assets, arranges for various types of financing and interest rate risk mitigation strategies, and provides administrative and managerial services in connection with our day-to-day operations, as may be required from time to time for our management and our assets (other than assets solely being managed by any other manager).

Management Agreement

Pursuant to the management agreement, as amended, ARRM is entitled to receive a monthly management fee equal to 1/12th of 1% of gross equity raised (including initial gross merger equity as well as any future gross equity raised) until gross equity raised is $50 million, inclusive of gross merger equity. Thereafter, the management fee shall be 1/12th of (a) 1.5% of gross equity raised up to $1 billion and (b) 0.75% of gross equity raised in excess of $1 billion, with a monthly minimum based on 1/12th of $900,000 (inclusive of the original gross merger equity). Since our business combination with Enterprise Acquisition Corp., ARRM has received an aggregate of approximately $254,000 in management fees from ARMOUR pursuant to the terms of the management agreement.

We pay all of our and ARRM's costs and expenses (including for goods and services obtained from third parties) incurred solely on behalf of us or any subsidiary or in connection with the management agreement, except for expenses related to the employment of ARRM personnel, rent, telephone, utilities, equipment and other office and internal and overhead expenses of ARRM required for our day to day operations.

The management agreement became effective in November 2009 and has an initial term of five years. Following the initial term, the management agreement automatically renews for successive one-year renewal terms unless we or

ARRM give notice to the other of its intent not to renew the agreement 180 days prior to the expiration of the initial term or any renewal term, as applicable.

For more information on our management agreement with ARRM, including further details on the definition of gross equity raised, please see the section of this prospectus entitled *Our Manager and the Management Agreement*.

Our Assets

Since commencing operations, our assets have been invested primarily in Agency Securities. As of June 30, 2010, our Agency Security portfolio, including both trades that had settled and forward settling trades that we had committed to settle, consisted of approximately $477.6 million, in market value, of Agency Securities with initial fixed-interest rate periods of three years, five years, seven years, ten years and 15 years.

Our Borrowings

We borrow against our Agency Securities using repurchase agreements. These borrowings generally have maturities that range from one month or less to up to one year, although occasionally we may enter into longer dated borrowing agreements to more closely match the rate adjustment period of the securities we own. Our total repurchase indebtedness was approximately $334.7 million at June 30, 2010, and had a weighted average maturity of 25 days. Depending on market conditions, we may enter into additional repurchase arrangements with similar longer-term maturities or a committed borrowing facility. Our borrowings are generally between six and ten times the amount of our stockholders

equity, but we are not limited to that range. The level of our borrowings may vary periodically depending on market conditions. Despite recent credit market developments and prevailing trends, we believe Agency Securities will continue to be eligible for financing in the repurchase agreement market.

Our Interest Rate Risk Mitigation

Our interest rate risk mitigation strategies are designed to reduce the impact on our income caused by the potential adverse effects of changes in interest rates on our assets and liabilities. Subject to complying with REIT requirements, we use derivative instruments to mitigate the risk of adverse changes in interest rates on the value of our assets as well as the differences between the interest rate adjustments on our assets and borrowings. These strategies primarily consist of purchasing or selling futures contracts (such as our previous purchase of Eurodollar futures) and may also include entering into interest rate swap agreements, interest rate cap or floor agreements, purchasing put and call options on securities or securities underlying futures contracts, or entering into forward rate agreements. Although we are not legally bound to use interest rate risk mitigation strategies, we intend to limit our use of derivative instruments to only those techniques described above and to enter into derivative transactions only with counterparties that we believe have a strong credit rating to help mitigate the risk of counterparty default or insolvency. These transactions are entered into solely for the purpose of mitigating interest rate and prepayment risk. Since we will not qualify for hedge accounting treatment as prescribed by U.S. generally accepted accounting principles, or GAAP, our operating results may reflect greater volatility than otherwise would be the case, because gains or losses on the derivative instruments may not be offset by changes in the fair values or cash flows of the related investment or borrowing transactions within the same accounting period, or ever.

Our Strategy and Competitive Advantages

Our objective is to realize attractive risk-adjusted returns to our stockholders over the long-term through selective acquisition of Agency Securities combined with strategic applications of leverage management, risk management and interest rate management strategies. We believe we possess the core strengths that will enable us to realize our objectives and provide us with competitive advantages in the marketplace. Our core strengths include:

Significant Experience of Our Management Team

We believe that the extensive experience of our management team at ARRM provides us with significant expertise across our target assets. Scott Ulm and Jeffrey Zimmer, our Co-Chief Executive Officers, have extensive experience in favorable and unfavorable economic cycles and in securities trading, interest rate risk mitigation, asset/liability management and analysis and leveraged mortgage finance.

The senior members of our research and investment team have an aggregate of 50 years of experience in mortgage-backed securities investing, including experience in performing advisory services for investment banks, funds, other investment vehicles and other managed and discretionary accounts. Mr. Ulm has 24 years of structured finance and debt capital markets experience, including mortgage-backed securities. Mr. Ulm has advised numerous U.S., European and Asian financial institutions and corporations on balance sheet and capital raising matters. Mr. Zimmer has significant experience in the mortgage-backed securities market over a 26 year period. See the sections of this prospectus entitled *Manager* and *Business-Prior Experience of Executive Managing Agency Securities Portfolio* for more information.

Disciplined Relative Value Investment Approach

We follow a disciplined security selection process and are, in essence, a relative value investor in Agency Securities. ARRM uses a cross-product approach, conducting top-down market assessments with respect to various subsets of the Agency Securities market in order to identify the most attractive segments and investment opportunities consistent with our portfolio objectives and risk management strategy. In employing this detailed analysis, ARRM seeks to

identify the best values available in Agency Securities. We select our Agency Securities based on extensive analysis including factors such as prepayment trends, average remaining life, amortization schedules, fixed versus floating interest rates, geographic concentration, property type, loan-to-value ratios and credit scores. Considering the large size of the Agency Securities market, we believe we can be very selective with our investments and buy only the securities we deem to be the most attractive.

Portfolio Construction

We anticipate that returns to our stockholders will be realized over the long-term primarily through the distribution of dividends and secondarily through capital appreciation. We intend to realize returns to our investors by constructing a well-balanced portfolio consisting primarily of shorter duration Agency Securities with a focus on managing various associated risks, including interest rate, prepayment, and financing risk. ARRM uses its fixed income expertise across the range of asset classes within the Agency Securities markets to build a portfolio that seeks to balance income, cash, capital,

leverage and the aforementioned risks. Through the careful and disciplined selection of assets, and continual portfolio monitoring, we believe we can build and maintain an investment portfolio that provides value to stockholders over time, both in absolute terms and relative to other Agency Securities portfolios.

Analytical Tools, Infrastructure and Expertise

ARRM's experienced investment team constructs and manages our Agency Securities investment portfolio through the use of focused qualitative and quantitative analysis, which helps us manage risk on a security-by-security and portfolio basis. We rely on a variety of analytical tools and models to assess our investments and risk management. We focus on in-depth analysis of the numerous factors that influence our target assets, including:

- fundamental market and sector review;
- cash flow analysis;
- controlled risk exposure; and
- prudent balance sheet management.

We also use these tools to guide the interest rate risk mitigation strategies developed by ARRM to the extent consistent with the requirements for qualification as a REIT.

Extensive Strategic Relationships and Experience of ARRM

ARRM maintains extensive relationships with financial intermediaries including prime brokers, investment banks, broker-dealers and asset custodians. We believe these relationships enhance our ability to source, finance, protect and mitigate the interest rate risk on our investments and, thus, enable us to succeed in various credit and interest rate environments. ARRM s management has many years of experience and well-established contacts within the Agency Securities, capital and financing markets, and are able to bring their personal relationships to bear for our benefit and the benefit of our stockholders.

Operating and Regulatory Structure

REIT Qualification

We have elected to qualify and be taxed as a REIT under the Internal Revenue Code, or the Code. We believe that we are organized in conformity with the requirements for qualification as a REIT under the Code and that our manner of operations and corporate structure and stockholder ownership enables us to meet on a continuing basis the requirements for taxation as a REIT for federal income tax purposes. As a REIT, we are generally not subject to federal income tax on the REIT taxable income that we distribute to our stockholders currently. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to federal

income tax at regular corporate rates. Even if we qualify as a REIT for federal income tax purposes, we may still be subject to some federal, state and local taxes on our income. For more information on the consequences to us of not satisfying the requirements for taxation as a REIT, see the section titled *Risk Factors*.

1940 Act Exemption

We conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, as amended, or the 1940 Act. If we were to fall within the definition of an investment company, we would be unable to conduct our business as described in this prospectus. *See Risk Factors Loss of our 1940 Act exemption would adversely affect us*.

Restrictions on Ownership of our Common Stock

To assist us in complying with the REIT limitations on the concentration of ownership imposed by the Code, among other purposes, our charter prohibits, with certain exceptions, any stockholder from beneficially or constructively owning, applying certain attribution rules under the Code (including deemed ownership of shares underlying warrants or options to purchase stock), more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock. Our board of directors may, in its sole discretion, waive the 9.8% ownership limit in certain circumstances. Currently, there are holders of our capital stock and/or warrants whose ownership exceeds the thresholds set forth in our charter. We have granted waivers from the 9.8% charter restriction for holders where, based on representations, covenants and agreements received from such holders, we determined that such waivers would not jeopardize our status as a REIT.

For more information on our operating and regulatory structure, see the section of this prospectus entitled *Business Operating and Regulatory Structure*.

Dividend Policy

In order to maintain our qualification as a REIT for U.S. federal income tax purposes, we are required to distribute at least 90% of our annual REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. Accordingly, we pay cash dividends of all or substantially all of our taxable income to holders of our common stock out of assets legally available for such purposes. We are not restricted from using the proceeds of equity or debt offerings to pay dividends, but we do not intend to do so. The timing and amount of any dividends we pay to holders of our common stock will be at the discretion of our board of directors and will depend upon various factors, including our earnings and financial condition, maintenance of REIT status, applicable provisions of the Maryland General Corporation Law, or MGCL, and such other factors as our board of directors deems relevant.

Summary Risk Factors

An investment in our common stock involves various risks. You should consider carefully the risks discussed below and under the heading *Risk Factors* beginning on page 8 of this prospectus before purchasing our common stock. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our securities could decline, and you may lose some or all of your investment.

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We have a limited operating history and may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

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Our failure to qualify as a REIT would subject us to federal income tax as a regular corporation and potentially increased state and local taxes, thereby reducing the amount of cash available for distribution to our stockholders.

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Continued adverse developments in the global capital markets, including defaults, credit losses and liquidity concerns, as well as mergers, acquisitions or bankruptcies of potential repurchase agreement counterparties, could make it difficult for us to borrow money to acquire Agency Securities on a leveraged basis, on favorable terms, or at all, which could adversely affect our profitability.

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Continued adverse developments in the residential mortgage market may adversely affect the value of the Agency Securities in which we invest.

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Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, the Agency Securities in which we invest.

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Our use of derivative instruments may expose us to counterparty risk.

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We may incur increased borrowing costs related to repurchase agreements which could harm our results of operations.

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Rapid changes in the values of our target assets may make it more difficult for us to maintain our qualification as a REIT or our exemption from the 1940 Act.

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We depend on ARRM and particularly key personnel including Messrs. Ulm and Zimmer. The loss of those key personnel could severely and detrimentally affect our operations.

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There are conflicts of interest in our relationship with ARRM and its affiliates, which could result in decisions that are not in the best interests of our stockholders or warrant holders.

Corporate Information

We were incorporated in the state of Maryland on February 5, 2008. On November 1, 2009, we consummated a business combination with Enterprise Acquisition Corp., a publicly traded blank check company formed for the purposes of acquiring an operating business. As a result of this transaction, which we refer to as the Business Combination, we became a publicly traded company.

Our principal offices are located at 3001 Ocean Drive, Suite 201, Vero Beach, Florida 32963. Our phone number is (772) 617-4340. Our website is www.ARMOURREIT.com. The contents of our website are not a part of this prospectus. The information on our website is not intended to form a part of or be incorporated by reference into this prospectus.

The Offering

Common Stock Offered By Us	4,000,000 shares Certain of our officers, directors and employees may participate in the offering on the same terms as the public.
Common stock to be outstanding after this Offering	11,414,054 shares We also have outstanding redeemable warrants to purchase an aggregate of 32,500,000 shares of our common stock that are currently exercisable through November 7, 2013 at an exercise price of $11.00 per share. These warrants likely will be exercised if the market price of the shares of our common stock equals or exceeds the warrant exercise price.
Use of Proceeds	We plan to use all of the net proceeds from this offering to acquire additional target assets, principally Agency Securities and Agency Debt, in accordance with our objectives and strategies described in this prospectus. See *Use of Proceeds.*
Dividend Policy	We intend to continue to make regular cash distributions to holders of our common stock consistent with maintaining our REIT qualification for U.S. federal income tax law purposes. To date, our distributions have been in the form of quarterly cash dividends. However, commencing in January 2011, we intend to declare and pay cash dividends to our stockholders on a monthly, rather than on a quarterly, basis. On November 5, 2009, we declared a dividend of $0.13 per share of common stock to stockholders of record as of October 5, 2009 and we paid the dividend in December 2009 and January 2010. On March 5, 2010, we declared a dividend of $0.40 per share of common stock to stockholders of record as of March 15, 2010, and we paid the dividend on April 29, 2010. On May 25, 2010, we declared a dividend of $0.40 per share of common stock to stockholders of record on June 3, 2010, which we paid on July 29, 2010. On September 14, 2010, we declared a dividend of $0.36 per share of common stock to stockholders of record as of September 23, 2010, which we paid on October 29, 2010. For more information, see *Dividend Policy.*
Listing	

	Our common stock and warrants are currently traded on the NYSE Amex under the symbols ARR and ARR.WS, respectively.
Ownership Restrictions	To assist us in qualifying as a REIT, ownership of shares of our common stock by any person is limited, with certain exceptions, to 9.8% by value or by number of shares, whichever is more restrictive, of our outstanding shares of common stock. Our charter also provides for certain other ownership restrictions. We have granted waivers from the 9.8% charter restriction for certain equity holders where, based on representations, covenants and agreements received from such holders, we determined that such waivers would not jeopardize our status as a REIT. For more information on our operating and regulatory structure, see the section of this prospectus entitled *Business Operating and Regulatory Structure*.
Risk Factors	Investing in our common stock involves risks. You should carefully read and consider the information set forth under the heading *Risk Factors* beginning on page 8 of this prospectus and all other information in this prospectus before investing in our common stock.

Summary Selected Financial And Other Data

The following table sets forth selected historical financial information derived from our unaudited financial statements for the quarter ended June 30, 2010 and our audited financial statements for the years ended December 31, 2009 and 2008. The following data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements including the notes thereto, included elsewhere in this prospectus. The financial data below, including the results of operations and key portfolio statistics for periods prior to the Business Combination are those of Enterprise Acquisition Corp., or Enterprise, and its investment strategy which differed significantly from our current operations.

	June 30, 2010 (unaudited)	December 31, 2009	December 31, 2008
Balance Sheet Data:			
Total Assets	$ 507,162,530	$ 126,693,608	$ 250,189,469
Repurchase Agreements	334,703,323	46,388,602	-
Payable for unsettled securities	114,870,537	58,559,479	-

	Quarter Ended June 30, 2010 (unaudited)	Year Ended December 31, 2009	Year Ended December 31, 2008
Statement of Operations and Per Share Data:			
Interest income, net of premium amortization	$ 1,415,686	$ 446,598	$ 5,425,560
Interest expense	(173,082)	(14,153)	-
Net interest income	1,242,604	432,445	5,425,560
Change in fair value of interest rate contracts	(1,456,525)	-	-
Gain on sale of agency securities	-	-	-
Total net revenues	(207,310)	483,308	5,425,560
Operating expenses	493,033	2,026,925	2,309,375
Net income (loss)	$ (700,343)	$ (1,149,427)	$ 1,074,435
Net income (loss) per share	$ (0.22)	$ (0.11)	$ (0.02)
Weighted average shares outstanding	3,146,362	20,459,664	23,750,001
Cash dividends declared per share	$ 0.40	$ 0.13	$ -
Book value per share (1)	$ 7.33	$ 9.33	$ 5.32

Key Portfolio Statistics*			
Average Agency Securities (2)	$ 189,823,439	$ 10,670,293	$ -
Average Repurchase Agreements (3)	$ 187,629,863	$ 5,531,866	$ -
Average Equity (4)	$ 54,319,364	$ 21,491,094	$ -
Average Portfolio Yield (5)	2.98%	4.59%	-
Average Cost of Funds (6)	0.37%	0.72%	-
Interest Rate Spread (7)	2.6%	3.87%	-
Return on Average Equity (8)	(1.29)%	(0.80)%	-
Average Annual Portfolio Repayment Rate (9)	15.4%	8.6%	-
Debt to Equity *(at period end)* (10)	6.16:1	2.16:1	-

Debt to Additional Paid in Capital *(at period end)* (11)	6.11:1	2.22:1	-

* Average numbers for each period are weighted based on days on books and records. All percentages are annualized.

(1)

Book value per share was calculated by dividing total stockholders equity by shares outstanding of 7,414,054, 2,304,054, and 31,250,000 at June 30, 2010, December 31, 2009, and December 31, 2008, respectively.

(2)

Our average investment in Agency Securities was calculated by dividing the sum of our daily Agency Securities investments during the period by the number of days in the period.

(3)

Our average balance outstanding under our repurchase agreements was calculated by dividing the sum of our daily outstanding balances under our repurchase agreements during the period by the number of days in the period.

(4)

Our average stockholders equity is ending stockholders equity for the year.

(5)

Our average portfolio yield was calculated by dividing our net interest income by our average Agency Securities or other investments.

(6)

Our average cost of funds was calculated by dividing our total interest expense (including interest rate risk mitigation) by our average borrowings.

(7)

Our interest rate spread was calculated by subtracting our average cost of funds from our average portfolio yield.

(8)

Our return on average equity was calculated by dividing net income by average equity.

(9)

Our average annual principal repayment rate was calculated by dividing our total principal payments received during the year (scheduled and unscheduled) by our average Agency Securities.

(10)

Our debt to equity ratio was calculated by dividing the amount outstanding under our repurchase agreements at period end by total stockholders' equity at period end.

(11)

Our debt to additional paid in capital ratio was calculated by dividing the amount outstanding under our repurchase agreements at period end by additional paid in capital at period end.

RISK FACTORS

An investment in our securities involves a high degree of risk. You should consider carefully the material risks described below, together with the other information contained in this prospectus, before making a decision to invest in our securities. If any of the following events occur, our business, financial condition and operating results may be materially adversely affected. In that event, the trading price of our securities could decline, and you could lose all or part of your investment. This prospectus also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of specific factors, including the risks described below.

Risks Related to Our Business

We have a limited operating history and may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

We were organized in 2008 and began investment activity in November 2009. We have a limited operating history on which to evaluate us and the past performance of ARRM and its key personnel should not be viewed as an indication of our future performance.

The results of our operations depend on many factors, including, without limitation:

- the availability of opportunities for the acquisition of attractively priced Agency Securities;
- the level and volatility of interest rates;
- the availability of readily accessible funding in the financial markets;
- our ability to cost-effectively hedge risks; and
- overall and general economic conditions.

We may not be able to maintain any agreements with our lenders on favorable terms or at all. Furthermore, we may not be able to operate our business successfully or implement our operating policies and strategies as described in this prospectus, which would harm our financial results and could result in the loss of some or all of your investment.

Continued adverse developments in the global capital markets, including defaults, credit losses and liquidity concerns, as well as mergers, acquisitions or bankruptcies of potential repurchase agreement counterparties, could make it difficult for us to borrow money to acquire Agency Securities on a leveraged basis, on favorable terms, or at all, which could adversely affect our profitability.

We rely on the availability of financing to acquire Agency Securities on a leveraged basis. Institutions from which we obtain financing may have invested in or financed mortgage-backed securities and other assets that have declined in value as a result of the recent downturn in the residential mortgage market, causing these institutions to suffer losses. If these conditions persist, these institutions may be forced to exit the repurchase market, become insolvent or further tighten their lending standards or increase the amount of equity capital or the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount required to obtain financing. Under such circumstances, it could be more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we were unable to obtain cost-effective financing for our investments.

While the overall financing environment has improved over the last twelve months, further credit losses or mergers, acquisitions, or bankruptcies of investment banks and commercial banks that have historically acted as repurchase agreement counterparties may occur. This would result in a fewer number of potential repurchase agreement counterparties operating in the market and could potentially impact the pricing and availability of financing for our business.

Continued adverse developments in the residential mortgage market may adversely affect the value of the Agency Securities in which we invest.

During the past few years, the residential mortgage market in the United States has experienced a variety of difficulties and changed economic conditions that have adversely affected the performance and market value of the Agency Securities in which we invest. Agency Securities originated in 2006 and 2007 have experienced a higher and earlier than expected rate of delinquencies. Additionally, other earlier vintages of Agency Securities may not be performing as expected. As a result, the market for these securities may be adversely affected for a significant period of time.

Conditions within the market are being driven primarily by:

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Delinquencies across a broad scope of mortgage loans that include subprime mortgage loans (loans that are made to borrowers with impaired credit), Alt-A mortgage loans (loans that are made to borrowers with limited documentation), and prime mortgage loans (loans that are made to borrowers with excellent credit who provide full documentation).

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Declining housing prices and flattening of property values,

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Resetting adjustable rate mortgages that result in increased mortgage payments, and

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Constrained ability by borrowers to refinance or sell their properties.

While we intend to primarily invest in Agency Securities, rising levels of delinquencies could negatively affect the value of our Agency Securities or create market uncertainty about their true value. At the same time, market uncertainty about residential mortgages in general could depress the market for Agency Securities, making it more difficult for us to sell any Agency Securities we own on favorable terms or at all.

The federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government, may adversely affect our business.

The payments we receive on the Agency Securities in which we invest depend upon a steady stream of payments by borrowers on the underlying mortgages and the fulfillment of guarantees by Ginnie Mae, Fannie Mae and Freddie Mac. Ginnie Mae is part of a U.S. Government agency and its guarantees are backed by the full faith and credit of the United States. Fannie Mae and Freddie Mac are U.S. Government-sponsored entities, but their guarantees are not backed by the full faith and credit of the United States.

Since 2007, Fannie Mae and Freddie Mac have reported substantial losses and a need for substantial amounts of additional capital. In response to the deteriorating financial condition of Fannie Mae and Freddie Mac and the credit market disruption, Congress and the U.S. Treasury undertook a series of actions to stabilize these government-sponsored entities and the financial markets generally. The Housing and Economic Recovery Act of 2008 was signed into law on July 30, 2008, and established the Federal Housing Finance Agency, or FHFA, with enhanced regulatory authority over, among other things, the business activities of Fannie Mae and Freddie Mac and the size of their portfolio holdings. On September 7, 2008, FHFA placed Fannie Mae and Freddie Mac into federal conservatorship and, together with the U.S. Treasury, established a program designed to boost investor confidence in Fannie Mae's and Freddie Mac's debt and Agency Securities. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs the operations of Fannie Mae and Freddie Mac and may (1) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of the stockholders, the directors, and the officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (2) collect all obligations and money due to Fannie Mae and Freddie Mac; (3) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (4) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (5) contract for assistance in fulfilling any function, activity, action or duty of the conservator.

Although the federal government has committed capital to Fannie Mae and Freddie Mac, there can be no assurance that these credit facilities and other capital infusions will be adequate for their needs. If the financial support is inadequate, these companies could continue to suffer losses and could fail to honor their guarantees and other obligations. Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the U.S. Treasury Secretary suggested that the guarantee payment structure of Fannie Mae and Freddie Mac should be re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency Security and could have broad adverse market implications.

The problems faced by Fannie Mae and Freddie Mac resulting in their being placed into federal conservatorship have stirred debate among some federal policy makers regarding the continued role of the U.S. Government in providing liquidity for the residential mortgage market. For example, in late January 2010, the Chairman of the House Financial Services Committee announced that the House Financial Services Committee will be recommending abolishing Fannie Mae and Freddie Mac in their current form and establishing a new system of providing housing finance. Following expiration of the current authorization, each of Fannie Mae and Freddie Mac could be dissolved and the U.S. Government could decide to stop providing liquidity support of any kind to the mortgage market. If Fannie Mae or Freddie Mac were eliminated, or their structures were to change radically, we would not be able to acquire Agency Securities from these companies, which would drastically reduce the amount and type of Agency Securities available for investment, which are our only targeted investments.

Our income could be negatively affected in a number of ways depending on the manner in which related events unfold. For example, the current credit support provided by the U.S. Treasury to Fannie Mae and Freddie Mac, and any additional credit support it may provide in the future, could have the effect of lowering the interest rate we expect to receive from Agency Securities that we seek to acquire, thereby tightening the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio. A reduction in the supply of Agency Securities could also negatively affect the pricing of Agency Securities we seek to acquire by reducing the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio.

In addition, in 2009, the U.S. Federal Reserve initiated a program to purchase $200.0 billion in direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks and $1.3 trillion in Agency Securities issued and guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. The U.S. Federal Reserve stated that its actions are intended to reduce the cost and increase the availability of credit for the purchase of houses, which in turn was expected to support housing markets and foster improved conditions in financial markets more generally. This purchase program was completed on March 31, 2010. It is unclear the degree to which the completion of this program and withdrawal of substantial demand for Agency Securities by the Federal Reserve will affect the price and liquidity of Agency Securities. We are unable to predict whether or when the US Treasury or the Federal Reserve will make further interventions in the Agency Securities markets, or what impact, if any, such action could have on the Agency Securities market, the Agency Securities we hold, our business, results of operations and financial condition. It is unclear the timing or manner in which the Federal Reserve might dispose of the Agency Securities it has acquired and, consequently, any impact on the Agency Securities market and the Agency Securities we hold.

In addition, in February of 2010, Fannie Mae and Freddie Mac announced that they would execute wholesale repurchases of loans which they considered seriously delinquent from existing mortgage pools. This action temporarily decreased the value of these securities until complete details of the programs and the timing were announced, and reduced our yield in the months of repayment. Freddie Mac implemented its purchase program in February 2010 with actual purchases beginning in March 2010. Fannie Mae began their process in March 2010 and announced it would implement the initial purchases over a period of three months, beginning in April 2010. Further, both agencies announced that on an ongoing basis they would purchase loans from the pools of mortgage loans underlying their mortgage pass-through certificates that became 120 days delinquent.

As indicated above, recent legislation has changed the relationship between Fannie Mae and Freddie Mac and the U.S. Government and requires Fannie Mae and Freddie Mac to reduce the amount of mortgage loans they own or for which they provide guarantees on Agency Securities. Future legislation could further change the relationship between Fannie Mae and Freddie Mac and the federal government, and could also nationalize or eliminate such entities entirely. Any law affecting these government-sponsored enterprises may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. As a result, such laws could increase the risk of loss on investments in Fannie Mae and/or Freddie Mac Agency Securities. It also is possible that such laws could adversely impact the market for such securities and spreads at which they trade. All of the foregoing could materially adversely affect our business, operations and financial condition.

Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, the Agency Securities in which we invest.

During 2008, the U.S. Government, through the Federal Housing Authority and the Federal Deposit Insurance Corporation, commenced implementation of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. In addition, members of the U.S. Congress have indicated support for additional legislative relief for homeowners, including an amendment of the bankruptcy laws to permit the modification of mortgage loans in bankruptcy proceedings. These loan modification programs, as well as future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans may

adversely affect the value of, and the returns on, the Agency Securities in which we invest.

We may not be able to operate our business or implement our operating policies and strategies successfully.

The results of our operations depend on many factors, including, without limitation, the availability of opportunities for the acquisition of attractively priced Agency Securities, the level and volatility of interest rates, readily accessible funding in the financial markets and our ability to cost-effectively hedge risks as well as overall economic conditions. We may not be able to maintain any agreements with our lenders on favorable terms or at all. Furthermore, we may not be able to operate our business successfully or implement our operating policies and strategies as described in this prospectus, which could result in the loss of some or all of your investment.

Increased levels of prepayments from Agency Securities may decrease our net interest income or result in a net loss.

Pools of mortgage loans underlie the Agency Securities that we acquire. We generally receive payments from the payments that are made on these underlying mortgage loans. When we acquire Agency Securities, we anticipate that the underlying mortgages will prepay at a projected rate generating an expected yield. When borrowers prepay their mortgage loans faster than expected, the related prepayments on the corresponding Agency Securities will be faster than expected. Since we typically purchase Agency Securities at premium prices that reflect above market coupons, faster-than-expected prepayments reduce the period those above market coupons are outstanding and could potentially harm our financial position and results of operations. Furthermore, while the Agency Securities we purchase are guaranteed against principal loss by Fannie Mae, Freddie Mac, or Ginnie Mae, defaults, serious delinquencies, and loan modifications of the underlying mortgages result in prepayment of principal as well. Continuing poor credit results at Fannie Mae, Freddie Mac, and Ginnie Mae would suggest higher rates of prepayments from defaults and serious delinquencies. While we will seek to manage prepayment risk, in selecting investments, we must balance prepayment risk against other risks, the potential returns of each investment and the cost of hedging its risks. No strategy can completely insulate us from prepayment or other such risks, and we may deliberately retain exposure to prepayment or other risks.

Recent market conditions may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our portfolio.

Our success depends on our ability to analyze the relationship of changing interest rates and prepayments of the mortgages that underlie our Agency Securities. Changes in interest rates and prepayments affect the market price of the Agency Securities that we purchase and any Agency Securities that we hold at a given time. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our portfolio. In conducting our analysis, we depend on industry-accepted assumptions with respect to the relationship between interest rates and prepayments under normal market conditions. If the dislocation in the residential mortgage market or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to assess the market value of our portfolio would be significantly affected and could materially adversely affect our financial position and results of operations.

The recent actions of the U.S. government, the Federal Reserve, the U.S. Treasury, and the Securities and Exchange Commission for the purpose of stabilizing the financial markets may adversely affect our business.

The U.S. government, the Federal Reserve, the U.S. Treasury, the SEC, and other governmental and regulatory bodies have taken or are considering taking various actions to address the financial crisis. For example, on July 21, 2010 President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act. The Dodd-Frank Act may impact the securitization market in that it requires, among other things, that a securitizer generally retain not less than 5% of the credit risk for certain types of securitized assets that are transferred, sold, or conveyed through issuance of an asset-backed security. Also, the SEC has proposed significant changes to Regulation AB, which, if adopted in their present form, could have sweeping changes to commercial and residential mortgage loan securitization markets as well as to the market for the resecuritization of mortgage-backed securities. There can be no assurances that such actions will have a beneficial impact on the financial markets. In addition to the foregoing, the U.S. Congress and/or various states and local legislatures may enact additional legislation or regulatory action designed to address the current economic crisis or for other purposes that could have a material adverse effect on our ability to execute our business strategies. To the extent the market does not respond favorably to these initiatives or they do not function as intended, they may not have a positive impact on our business.

The increasing number of proposed U.S. federal, state and local laws and regulations may affect certain mortgage-related assets in which we intend to invest and could increase our cost of doing business.

Legislation has been proposed which, among other provisions, could hinder the ability of a servicer to foreclose promptly on defaulted mortgage loans or would permit limited assignee liability for certain violations in the mortgage loan origination process. For example, the Dodd-Frank Act permits borrowers to assert certain defenses to foreclosure against an assignee for certain violations in the mortgage loan origination process. We cannot predict whether or in what form the U.S. Congress, the various state "border-top:3px double #000000">

See accompanying notes.

ADA-ES, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

March 31, 2008

(1) Basis of Presentation

ADA-ES, Inc. (ADA) and its wholly owned subsidiaries, ADA Environmental Solutions, LLC (ADA LLC), Red River Environmental Products, LLC, Bowman Environmental Products, LLC, Underwood Environmental Products, LLC and its 50% joint venture interest in Clean Coal Solutions, LLC (Clean Coal), are collectively referred to as the Company. The Company is principally engaged in providing environmental technologies and specialty chemicals to the coal-burning utility industry. The Company generates a substantial part of its revenue from the supply of Activated Carbon Injection (ACI) Systems and contracts co-funded by the government and industry. The Company s sales occur principally throughout the United States.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The consolidated financial statements include the financial statements of ADA-ES, its subsidiaries and Clean Coal. We have eliminated all significant intercompany balances and transactions in consolidation.

In the opinion of management, the consolidated financial statements include all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of operations, financial position and cash flows for the interim periods presented. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

These statements should be read in conjunction with the consolidated financial statements and related notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007. The accounting policies used in preparing these consolidated financial statements are the same as those described in our Form 10-K.

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(2) Net Loss Per Share

Basic loss per share is computed based on the weighted average common shares outstanding in the period. Diluted income per share is computed based on the weighted average common shares outstanding in the period and the effect of dilutive securities (stock options and awards) except where the inclusion is anti-dilutive.

All outstanding stock options, see Note 4, to purchase shares of common stock for the quarters ended March 31, 2008 and 2007 were excluded from the calculation of diluted shares as their effect is anti-dilutive.

(3) Property and Equipment

Property and equipment consisted of the following at the dates indicated:

	Life in years	As of March 31, 2008	As of December 31, 2007
		(In thousands)	
Machinery and equipment	3-10	$ 1,974	$ 1,881
Leasehold improvements	3	504	504
Furniture and fixtures	3-7	235	237
		2,713	2,622
Less accumulated depreciation and amortization		(1,485)	(1,372)
Total property and equipment, net		$ 1,228	$ 1,250

Depreciation and amortization of property and equipment for the quarters ended March 31, 2008 and 2007 was $113,000 and $77,000, respectively.

(4) Stock Options and Equity

During 2003, the Company adopted the 2003 ADA-ES, Inc. Stock Option Plan and reserved 400,000 shares of Common Stock for issuance under the plan. In general, all options granted under the plan expire ten years from the date of grant unless otherwise specified by the Company s Board of Directors. The exercise price of an option was determined by the compensation committee of the Board of Directors at the time the option was granted and was equal to 100% of the fair market value of a share of our Common Stock on the date the option is granted. This plan was cancelled and replaced by the 2007 Equity Incentive Plan described below, and as result, 148,506 shares of Common Stock originally reserved for issuance upon exercise of options grantable under the 2003 Plan were removed from the 2003 Plan. In 2007, 3,354 options were exercised and 5,500 options were forfeited. During 2008, 8,500 options were forfeited. As of March 31, 2008, 74,612 options remained outstanding and exercisable.

During 2004, the Company adopted the 2004 Executive Stock Option Plan. This plan authorized the grant of up to 200,000 options to purchase shares of the Company s Common Stock to executive officers of the Company, all of which were granted in 2004. The option exercise price of $8.60 per share was the market price on the date of the grant. The options are exercisable over a 10-year period based on a vesting schedule that may be accelerated based on performance of the individual recipients as determined by the Board of Directors. In February 2007, the Board of Directors authorized the vesting of 17,258 options under this plan with a fair value of $35,000. In 2007, 7,057 previously vested options were exercised. As of March 31, 2008, 166,663 options remain outstanding of which 49,429 options were exercisable.

During 2004, the Company adopted a plan (the 2004 Plan) for the issuance of shares and the grant of options to purchase shares of the Company s Common Stock to the Company s non-management directors. The 2004 Plan provided for the award of stock of 603 shares per individual non-management director or 4,221 shares in total, and the grant of options to purchase 5,000 shares of common stock per individual non-management director, or 35,000 in total, all of which were formally granted and issued in 2005 after approval of the 2004 Plan by the Company s shareholders. The option exercise price of $13.80 per share for the stock options granted on November 4, 2004 was the market price on the date of the grant. The options are exercisable over a period of five years and will vest over a three-year period, one-third each year for continued service on the Board. If such service is terminated, the non-vested portion of the option will be forfeited. In 2007, 985 of such options were exercised and 4,015 of options were forfeited upon the death of a director. As of March 31, 2008, 13,333 options were outstanding and 8,333 options were exercisable under the 2004 Plan.

During 2005, the Company adopted the 2005 Directors Compensation Plan (the 2005 Plan), which authorized the issuance of shares of Common Stock and the grant of options to purchase shares of the Company s Common Stock to non-management directors. The 2005 Plan provides a portion of the annual compensation to non-management directors of the Company in the form of awards of shares of Common Stock and vesting of options to purchase Common Stock of the Company for services performed for the Company. Under the 2005 Plan, the award of stock is limited to not more than 1,000 shares per individual per year, and the grant of options is limited to 5,000 per individual in total. The aggregate number of shares of Common Stock reserved for issuance under the 2005 Plan totals 90,000 shares (50,000 in the form of stock awards and 40,000 in the form of options).

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The exercise price for options granted under the 2005 Plan will be the market price on the date of grant, the shares of Common Stock underlying the option will vest at a rate of no more than 1,667 shares per annual period per individual, and any unvested options that are outstanding at the date the individual is no longer a Director will be forfeited. The 2005 Plan, if not terminated earlier by the Board, will terminate ten years after the date of its adoption. As of March 31, 2008, 15,000 options remain outstanding of which 5,000 options were vested and exercisable.

Following is a table of options activity for the quarter ended March 31, 2008:

	Director & Employee Options	Non-Employee Options	Weighted Average Exercise Price
OPTIONS OUTSTANDING, January 1, 2008	281,358	59,000	$ 10.45
Granted			
Exercised			
Forfeited	(11,750)		(17.54)
OPTIONS OUTSTANDING, March 31, 2008	269,608	59,000	$ 10.20
OPTIONS EXERCISABLE, March 31, 2008	137,374	59,000	$ 10.81

No options were exercised during the quarter ended March 31, 2008. The aggregate intrinsic value of options exercisable at March 31, 2008 was a loss of ($503,000) based on a market price of $8.25.

Stock options outstanding at March 31, 2008 are summarized in the table below:

	Options Outstanding		Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Lives	Weighted Average Exercise Price
$2.80	11,665	$ 2.80	11,665	5.6	$ 2.80
$8.60 - $10.00	228,343	$ 8.91	111,109	6.2	$ 9.23
$13.80 - $15.25	88,600	$ 14.51	73,600	5.7	$ 14.46
	328,608	$ 10.20	196,374	6.0	$ 10.81

No options were granted in the first quarter of either 2008 or 2007.

During 2007, the Company adopted the 2007 Equity Incentive Plan (the 2007 Plan), which replaces the 2003 Plan. The 2007 Plan authorizes the issuance to employees, directors and consultants of up to 600,000 shares of common stock, either as restricted stock grants or to underlie options to purchase shares of the Company s common stock. Under the 2007 Plan, awards of stock (in the form of restricted stock or shares underlying stock options) are limited to not more than 30,000 shares per individual per year with a maximum of 10,000 shares grantable in any year to non-management directors. In general, all options granted under the 2007 Plan will expire ten years from the date of grant unless otherwise specified by the Company s Board of Directors. The exercise price for options granted under the 2007 Plan will be the market price on the date of grant and the shares of common stock underlying the option will vest on the passage of specified times following the date of grant, the occurrence of one of more events, the satisfaction of performance criteria or other conditions specified by the Company s Board of Directors.

During 2007, the Board of Directors awarded restricted stock under the 2007 Plan. All non-executive employees and certain officers were entitled to an award of restricted stock under the following conditions: (1) employees that had not received stock options upon commencement of employment received a restricted stock award based on a percentage of their starting salaries; (2) employees that had received stock options upon commencement of employment had the option to exchange any remaining stock options outstanding for a restricted stock award based on

their starting salary; and (3) employees with five or more years of service received a restricted stock award based on a percent of their current annual salary. The purchase price for restricted stock was $0.01 per share and the restricted stock vests over a five-year period on an annual basis. The stock based compensation related to the restricted stock awards was determined using the fair value of the Company s stock on the date of grant, which was $12.60.

In October 2007, seven employees opted to exchange 42,700 outstanding options for 3,389 shares of restricted stock. The exchange did not result in any stock option modification costs. Unvested shares of restricted stock are subject to repurchase by the Company upon termination of employment with the Company. In December 2007, 5,000 shares of restricted stock were awarded to a new employee upon commencement of employment in addition to the normal award based on a percentage of their starting salary, which vests over a two-year period. The stock based compensation related to the restricted stock award is based on the fair market value of a share of our Common Stock on the date of the award. In the first quarter of 2008, 107,535 shares of restricted stock were awarded to new and existing employees. As of March 31, 2008, the Company recognized $163,000 of compensation costs related to the vesting of restricted stock during the quarter then ended a portion of which was capitalized.

A summary of the status of the non-vested shares as of March 31, 2008 is presented below:

Non-vested Shares	**Shares**	**Weighted Average Grant Date Fair Value**
Non-vested at January 1, 2008	26,673	$ 10.62
Granted	107,535	8.75
Vested	(6,969)	9.74
Forfeited	(476)	12.60
Non-vested at March 31, 2008	126,763	$ 9.22

As of March 31, 2008, there was $504,000 of total unrecognized cost related to non-vested share-based compensation arrangements granted under the Company s equity incentive plans. This cost is expected to be recognized over a 5 year period. The total fair value of shares underlying stock options which vested during the quarters ended March 31, 2008 and 2007 was $7,000 and $94,000, respectively.

(5) Income Taxes

We adopted the provisions of FIN 48 on January 1, 2007. Our policy is to reflect penalties and interest related to FIN 48 issues as part of income tax expense as they become applicable. No unrecognized tax benefits were recorded as of March 31, 2008. We file income tax returns in the U.S. federal and various state jurisdictions. We are no longer subject to U.S. federal and state and local examinations by tax authorities for years before 2004 and Colorado state examinations for years before 2003.

(6) Capitalized Development Costs

We are capitalizing all direct and identifiable incremental costs associated with our development efforts to build an activated carbon manufacturing facility. As of March 31, 2008, such costs totaled $12.1 million, and are included in Development Projects on the accompanying consolidated balance sheets. Such development costs are generally deferred and either (a) expensed when it has been determined they are no longer of future value, or (b) capitalized as part of long-term assets.

(7) Commitments and Contingencies

Under certain contracts to supply activated carbon injection systems, the Company may grant performance guarantees to the owner of the power plants that guarantee the performance of the associated equipment for a specified period. The Company may also guarantee the achievement of a certain level of mercury removal based upon the injection of a specified quantity of a qualified activated carbon at a specified rate given other plant operating conditions. In the event the equipment fails to perform as specified, the Company is obligated to correct or replace the equipment. In the event the level of mercury removal is not achieved, the Company has a make right obligation within the contract limits. The Company assesses the risks inherent in each applicable contract and accrues an estimate that is based on costs incurred over the performance period of the contract. In some cases a performance bond may be purchased and held for the period of the warranty that can be used to satisfy the obligation. Such costs are included in our accrued warranty and other liabilities in the accompanying balance sheets. Any warranty costs paid out in the future will be charged against the accrual. The adequacy of warranty accrual balances is assessed at least quarterly based on current facts and circumstances and adjustments are made as needed.

The change in the carrying amount for our performance guarantees follows:

	Quarter Ended March 31, 2008	2007
	(In thousands)	
Balance as of January 1	$ 309	$ 120
Performance guarantees issued	77	30
Expenses paid	(17)	
Balance as of March 31	$ 369	$ 150

(8) <u>Business Segment Information</u>

The following information relates to the Company s two reportable segments: Mercury emission control (MEC) and Flue gas conditioning and other (FGC). All assets are located in the U.S. and are not evaluated by management on a segment basis. All significant customers are U.S. companies.

	Quarter Ended March 31, 2008	2007
	(In thousands)	
Revenue:		
MEC	$ 3,900	$ 3,629
FGC	103	275
Total	$ 4,003	$ 3,904
Segment profit:		
MEC	$ 900	$ 996
FGC	(67)	3
Total	$ 833	$ 999

A reconciliation of the reported total segment profit to net loss for the periods shown above is as follows:

	Quarter Ended March 31, 2008	2007
	(In thousands)	
Total segment profit	$ 833	$ 999
Non-allocated general and administrative expenses	(1,236)	(1,227)
Depreciation and amortization	(118)	(84)
Interest, other income and deferred income tax benefit	353	289
Net loss	$ (168)	$ (23)

Non-allocated general and administrative expenses include costs that benefit the business as a whole and are not directly related to one of our segments. Such costs include but are not limited to accounting and human resources staff, information systems costs, facility costs, audit fees and corporate governance expenses.

(9) Recently Issued Accounting Pronouncements

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards No. 157 Fair Value Measurements (SFAS 157). SFAS 157 introduces a framework for measuring fair value and expands required disclosure about fair value measurements of assets and liabilities. Currently we have one level I asset which is available for sale securities and they are reported at the fair market value. The impact of adoption had no material impact on our financial statements.

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards No. 159 (SFAS 159) The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is expected to expand the use of fair value measurement, which is consistent with the FASB s long-term measurement objective for accounting for financial instruments.

The impact of adoption had no material impact on our financial statements.

In June 2007, the FASB also ratified EITF 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities (EITF 07-3). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007. The impact of adoption had no material impact on our financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. SFAS No. 160 requires the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent s equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income. SFAS No. 160 is effective for fiscal years and fiscal quarters beginning on or after December 15, 2008. We are currently evaluating the impact of this pronouncement on our financial position and results of operations.

In December 2007, the FASB also issued SFAS 141 (revised 2007), Business Combinations , (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, including goodwill, the liabilities assumed and any non-controlling interest in the acquiree. SFAS 141R also establishes disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The impact of adopting SFAS 141R will be dependent on the future business combinations we may pursue after its effective date. Under SFAS 141R, all acquisition costs are expensed as incurred.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

This Report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties. Words or phrases such as anticipate, assume, believe, hope, expect, intend, plan, the negative expressions of such w similar expressions are used in this Report to identify forward-looking statements, and such forward-looking statements include, but are not limited to, statements or expectations regarding:

(a) the impact of national and state mercury regulations on the nation s 1,100-plus coal-fired units;
(b) rapid development of the mercury emission control market;
(c) expected growth in the power industry s interest in DOE carbon dioxide removal projects;
(d) annual lease costs and other expenditures and gross margins;
(e) the size of the applicable target market and market potential for Refined Coal Technology and ADA-249M;
(f) our expectation that changes in tax laws will be passed to clarify the conditions applicable to Section 45 tax credits and the timing of those changes in the tax laws;
(g) the timing of completion of projects and future demonstrations;
(h) the procession of outstanding bid requests to orders between now and 2010;
(i) the expected costs and timing for the development of a Greenfield AC manufacturing facility;
(j) our ability to obtain necessary permits for the construction of a planned Greenfield AC manufacturing facility;
(k) our ability to raise the funds necessary to maintain our desired level of participation in our planned AC manufacturing facility;
(l) our ability to enter into appropriate arrangements with a strategic partner to share development costs of our planned AC manufacturing facility;
(m) our ability to enter into suitable long-term contracts for the raw feedstock material necessary to supply our planned AC manufacturing facility;
(n) our ability to enter into suitable long-term contracts for the delivery of AC from our planned AC manufacturing facility and our ability to be able to timely deliver the AC required by such contracts;
(o) our ability to obtain adequate long-term debt financing for our planned AC manufacturing facility;
(p) our ability to meet a significant portion of the expected shortage in AC supply, including in the near-term (2008 and 2009) from interim sources, and in the longer term (2010 and beyond) from our new AC manufacturing facility;
(q) the appropriation of funds by Congress for DOE projects;
(r) impact of market price risk with respect to our stock and the impact of such risks on our ability to raise needed capital; and
(s) the immateriality of any future adjustments to previously received revenue as a result of DOE audits.

The forward-looking statements included in this Report involve significant risks and uncertainties. Actual events or results could differ materially from those discussed in the forward-looking statements as a result of various factors including, but not limited to: changing economic conditions and market demand for our products and services, changes in technology, availability of and demand for alternative energy sources, failure to satisfy performance guarantees, availability of adequate supplies of treatable carbon at reasonable prices to meet interim AC demand, the availability of federal funding to support certain of our research and development work, the availability of funding needed for the construction of our new AC manufacturing plant on reasonable terms, our ability to secure necessary permits and other regulatory approvals, to negotiate and enter into ancillary agreements needed to allow us to finance, design and build the new AC plant and to obtain necessary raw materials to supply the plant, anticipated or unexpected changes in laws or regulations, results of demonstrations of ADA s and other s licensed technologies, operational difficulties, availability of skilled personnel and other risks related to the development, construction and placing into operation of an activated carbon manufacturing facility, as well as other factors relating to our business, as described in our filings with the U.S. Securities and Exchange Commission, with particular emphasis on the risk factor disclosures contained in those filings. You are cautioned not to place undue reliance on the forward-looking statements made in this release, and to consult filings we have made and will make with the SEC for additional discussion concerning risks and uncertainties that may apply to our business and the ownership of our securities. The forward-looking statements contained in this Report are presented as of the date hereof, and we disclaim any duty to update such statements unless required by law to do so.

Overview

We provide environmental technologies and specialty chemicals to the coal-burning electric utility industry. Revenues are generated through (1) time and materials and fixed-price contracts for the emerging mercury emission control (MEC) market, several of which are co-funded by government (Department of Energy DOE) and industry and (2) the sale of specialty chemicals and services for flue gas conditioning (FGC) and other applications.

Mercury has been identified as a toxic substance and, pursuant to a court order, the EPA issued regulations for its control in March 2005. A dozen States and several environmental groups had previously sued the EPA alleging that the process that resulted in the relatively lenient Clean Air Mercury Rule (CAMR) violated the Clean Air Act and that CAMR was therefore invalid. In February 2008, the United States Court of Appeals for the District of Columbia Circuit ruled in favor of the plaintiffs in that case, holding that the EPA violated the Clean Air Act in the process it used to enact CAMR, and that CAMR was therefore invalid. The Court s ruling remands the matter to the EPA for further proceeding; however, EPA has filed an appeal of the ruling with the Court. In the interim, the lack of clear regulations has generated some short-term uncertainty among utilities as to what they will be required to do to reduce mercury emissions. However, we believe that the likely result will be that either EPA will adopt stricter mercury emission control rules or Congress will enact new legislation requiring stricter mercury emission control within the next year or two. We believe that the long-term growth of the MEC market for the electric utility industry will most likely depend on how industry chooses to respond to federal and state regulations. As many as 1,100 existing coal-fired boilers may be affected by such regulations, if and when they are fully implemented. We have recently seen an increase in new plant projects. DOE s latest report issued in 2007 includes 121 potential new projects totaling 71GW of capacity. Permitting of new coal-fired plants generally requires them to meet more stringent requirements that likely include MEC. For the near-term, our revenues from this market will be dependent on (i) DOE- and industry-funded contracts mentioned above, (ii) mercury testing services and (iii) equipment sales and sorbents sold to new plants and existing plants affected by the implementation of enacted regulations. State regulations and increasing numbers of consent decrees are currently the largest market driver for this part of our business. Although we expect this market to show steady growth over the next several years, we believe the most significant revenue growth will occur when final federal regulations impact a significant portion of previously uncontrolled, existing boilers.

The market for our FGC chemicals and services has been declining over the last couple of years, and is expected to continue to decline in the near-term; at least until the recent CAMR ruling has been better defined. Prior to the CAMR ruling we were responding to inquires about our product meeting the needs of the changing regulations in combination with mercury emissions. Although margins, on these products are declining, they are typically higher than what we recognize for our present MEC sales and represent an important, but decreasing, contribution to our overall revenue and profitability.

Thus far in 2008, we have signed contracts or orders to proceed for 4 ACI systems to be delivered in 2008 through 2010, bringing our total number of ACI systems installed or currently in process to 33. During the three months ended March 31, 2008 we recognized approximately $2.4 million in revenue related to ACI system sales. Unrecognized remaining revenues from ACI contracts totaled approximately $10.4 million as of March 31, 2008 and are expected to be recognized from 2008 through 2010. ACI systems are usually delivered from 12 to 16 months after the award, but may be in excess of 2 years for installations at new power plants.

We expect the supply of ACI systems to be our dominant revenue source for 2008 and expect to bid on between 50 and 100 ACI systems through 2009 based upon current regulations. Given the uncertainties surrounding the recent court ruling and appeal concerning CAMR we are projecting lower sales of ACI systems for 2008 over previous expectations.

We are continuing to commit the necessary resources to the development of a new Greenfield AC manufacturing facility. Previously, we had announced that in order to stay ahead of an expected billion dollar market, we had undertaken preliminary activities for the new facility including plant design, initial permitting, securing key lignite reserves, and third-party market analysis. Approved and funded activities completed in 2008 include: the selection of an engineering, procurement and construction company to perform preliminary work needed to build the plant; initial equipment orders; applications for environmental permitting; and initial site development. We expect to obtain the operating permit for the first two production lines within the first half of 2008. We are continuing the process of specifying and sourcing of key capital equipment, although we are currently curtailing nonessential expenditures pending confirmation of project costs and timetable and finalization of critical agreements, including supply agreements and those with our intended strategic partner.

We are planning to secure 60% of the financing, or what we expect will be approximately $180 million, through debt. We are working to support the senior project debt with off-take contracts for the activated carbon that we will be supplying through both interim sources and the new production from the plant. We expect to put in place long-term take or pay off-take contracts for AC that will have a total contract value of approximately $250 million. In addition to the debt financing, we anticipate sourcing 40% of the expected project funding requirements, or approximately $120 million, through equity. Our financing plan is based on splitting this into $60 million at the project level and $60 million at the ADA corporate level. The project equity investment is being raised through an anticipated investment by a strategic partner. After considering Indicative Bid Letters from a number of substantial financial and strategic firms with significant experience in the energy sector, we selected a partner and are now developing the detailed legal documents and operating agreement to define our relationship, which we hope to enter into in May. The intended partner is well-capitalized and has significant plant operational experience, contracting and transportation expertise, and demonstrated success at developing large projects. The intended strategic partner has also agreed in principal to provide an additional investment of up to $40 million at the ADA corporate level through the purchase of convertible preferred shares to supplement our existing resources. In the near future, we intend to submit to our shareholders a request for their approval to issue these convertible preferred shares.

In the first quarter of 2008, we signed an asset purchase agreement to acquire the assets of an AC processing facility in the south central United States. The purchased assets include 500,000 pounds of AC inventory, process equipment for chemical treatment, milling and storage of AC, and six pneumatic discharge trailers for transporting AC to utility customers. In addition to the purchase of assets, we have agreed to sign a three-year facility lease to rent the facility currently being used by the owner of the assets. We have also signed a non-binding letter of intent to pursue negotiations for a supply agreement for activated carbon that would be used for supplying our customers with AC prior to our planned activated carbon manufacturing facility becoming operational.

We also produced our first batches of AC from this facility and completed the first performance tests of our own AC product at a power plant in the first quarter of 2008. While operating with our AC, mercury emissions were reduced by greater than 90% at a very competitive feed rate. To control mercury for these plants it is necessary to use the higher priced chemically treated AC. We intend to put together the facilities and sourcing contracts so that by the end of 2008, we can supply up to 10 million pounds of AC per year and increase capacity to 30 to 50 million pounds per year by the end of 2009. Capital expenditures are expected to be less than $2 million. Given the expected costs of the foreign carbons to be used as feedstock plus the transportation expenses in shipping AC from overseas, this business is expected to operate at an approximately 20% gross margin. Assuming our new Greenfield manufacturing plant becomes operational, we expect the margins for AC produced from that source to increase to 60% or higher.

Results of Operations 1st Quarter 2008 versus 1st Quarter 2007

Revenues totaled $4.0 million for 2008 versus $3.9 million in 2007, representing an increase of 3%. Revenues in our MEC segment for 2008 increased by $271,000 (7%), and FGC and other activities decreased by ($172,000) (63%).

Revenues in 2008 from the MEC segment were comprised of sales of ACI systems (62%), government and industry-supported contracts (37%) and consulting services (2%), compared to 49%, 42% and 9%, respectively, in 2007. For the quarter, our ACI systems sales contributed approximately $2.4 million to MEC revenues, increasing 35% from the 2007 contribution to revenue of $1.8 million. We had contracts in progress at quarter-end for supply of ACI systems with remaining revenue of approximately $10.4 million, $5.3 million of which we expect to complete and realize in 2008, with the balance to be completed and realized in 2009 and 2010. The most significant growth occurred in the sales and installations of ACI systems, which increased $627,000 in the quarter and is the result of an increasing number of system sales as noted above.

Such increase is less than initially anticipated as a result of the uncertainty surrounding the recent CAMR ruling. Currently we are aware that utilities have postponed plans on at least 12 installations of ACI systems due to the CAMR ruling. However, we expect growth in 2008 in the MEC segment to result primarily from an increasing number of retrofit ACI systems in response to mercury emission control legislation. Our DOE and industry demonstration contract revenues totaled $1.4 million, representing a decrease of 5% from 2007 revenues. The remaining unearned amount of the contracts was $4.2 million as of March 31, 2008, of which $2.2 million is expected to be recognized in 2008 (including cash contributions by other industry partners). As reported earlier, future commitments on two other projects have not been made as of March 31, 2008 in the amount of $600,000, and it is unclear whether the funds will be allocated and paid on the contracts. This amount is not included in the $4.2 million noted above. Consequently those funds remain at risk pending funding decisions by DOE, and it is possible that other contract amounts could also be decreased or eliminated. We expect the DOE funding for mercury related projects to continue to decline or be eliminated, however we expect increased funding for CO_2 technology from government and industry supported contracts will begin to replace that source of revenue for us beginning in late 2008 and continuing into 2009.

Our contracts with the government are subject to audit by the federal government, which could result in adjustment(s) to previously recognized revenue. We believe, however, that we have complied with all requirements of the contracts and future adjustments, if any, will not be material. In addition, the federal government must appropriate funds on an annual basis to support DOE contracts, and funding is always subject to unknown and uncontrollable contingencies. Revenues from consulting services included in the MEC segment decreased approximately $273,000 or 81% from 2007 to 2008.

FGC and other revenues decreased by $172,000 or 63% due to fewer shipments of chemicals to continuing customers. We expect FGC and other revenues in 2008 to be lower than 2007. Demonstrations planned for 2008 have been delayed also due to the recent CAMR ruling and we are unsure at this juncture if these demonstrations will be conducted. Sales related to our ADA-249M product are recorded in the FGC and other segments and were $18,000 and $15,000 for the quarters ended March 31, 2008 and 2007, respectively.

Cost of revenues increased by $369,000 or 16% in 2008 from 2007 primarily as a result of increased volume and changes in our business mix as discussed below. Gross margins were 33% for the first quarter as compared to 41% in 2007. The decrease reflects decreased margins in both MEC and FGC and other segments. For the near term, we expect the sales of mercury control systems to continue to represent an increasing source of revenues, for which the anticipated gross margins are lower than for our specialty chemical sales and DOE demonstration work that involves industry cost sharing. As a result, we expect the gross margin for fiscal year 2008 to be lower than the margin realized in fiscal year 2007.

Cost of revenues for the MEC segment increased by $415,000 in 2008 or 19%, as compared to 2007 primarily as a result of the increased revenue generating activities from our ACI system sales. Gross margins for this segment were 33% for the first quarter as compared to 40% for 2007. The decline in gross margins from the prior year resulted from a decrease in government and industry supported revenue which has historically generated higher margins as an overall percentage of the revenue as compared to the same quarter in the previous year. Another factor in the decline of the margins in the ACI systems market is increased downward pricing pressure as a result of competition. Increased competition in this area has, and we expect will continue, to require us to lower our margins to maintain our desired market share. We have taken numerous steps to decrease costs and improve efficiencies to maintain acceptable margins from our ACI system sales. Looking further ahead, we expect CO_2 government and industry supported demonstration work and sales of activated carbon to positively affect margins.

Cost of revenues for the FGC and other segment decreased by $46,000 or 34% in 2008, as compared to 2007. Gross margins for this segment were 14% for 2008 as compared to 51% in 2007. The decrease in gross margins from 2008 to 2007 is a result of increased FGC sales of a product we license from ARKAY Technologies, which carry a lower margin than historical FGC sales, and direct costs related to the current joint venture activities of Clean Coal. FGC and other revenues comprised 3% of total revenues in 2008, compared to 7% in 2007. The changes in the FGC segment profits from 2008 to 2007 are a result of the same factors.

We expect the amount of fixed price and time and materials work in the MEC segment for the near term to represent an increasing source of revenue. Overall gross margins for 2008 are therefore expected to decline somewhat from the levels achieved in 2007, as a result of an increasing proportion of fixed price and time and materials work, and pricing pressure caused by increased competition.

General and administrative expenses increased by $33,000 or 2% to $1.5 million in 2008. The dollar increase in 2008 resulted primarily from increased administrative wage costs ($98,000); increased vacation wages ($42,000) offset by lower SOx 404 compliance, consulting and outside labor costs ($109,000). Our costs are substantially consistent with those from the previous year. We have been hiring personnel in response to the growth we have realized in the past and expect to achieve in 2008. Adequate resources of skilled labor have been and are expected to be available to meet anticipated needs.

We incur R&D expenses not only on direct activities we conduct but also by sharing a portion of the costs in the government and industry programs in which we participate. Direct research and development expenses decreased by $122,000 or 34% in 2008 as compared to 2007 as a result of a decrease in DOE contract activities. Future consolidated direct research and development expenses, except for those anticipated to be funded by the DOE contracts and others that may be awarded, are expected to continue to grow at a rate of about 10% annually for the next several years. Of the amount incurred in 2008, only $5,000 was directly related to DOE contracts as compared to $125,000 in the same period in 2007.

MEC segment profits decreased by $96,000 or 10% to $900,000 as compared to 2007. The decrease was primarily a result of lower margins on increased MEC segment revenues from our ACI systems and lower revenues from our DOE contracts that historically have higher margins than ACI systems revenue. FGC and other segment loss was $67,000 as compared to a profit of $3,000 as compared to 2007. The decrease was primarily the result of lower margin chemical sales and decreasing segment revenues.

We had net interest and other income of $169,000 in 2008, as compared to $266,000 for 2007. Interest and other income decreased in 2008 due to our increased funding commitments on our development projects and other activities, which has resulted in lower invested balances. In addition a decrease in interest rates is occurring and will reduce interest income on amounts invested in interest bearing accounts.

Other income and expense included our minority interest in the loss in Clean Coal, our joint venture with an affiliate of NexGen Resources Corporation, which is pursuing Refined Coal (RC) opportunities. The minority interest in the loss of Clean Coal amounted to $17,000 in 2008. Our net operating loss for the period ended March 31, 2008 includes net costs of $88,000 related to our RC efforts and $34,000 loss of the joint venture. We incurred an additional $54,000 of expenses related to our direct Clean Coal joint venture activities in 2008. If Clean Coal succeeds in obtaining approval for the Section 45 tax credits, NexGen has the right to maintain its 50% interest by paying us an additional $4.0 million, in eight quarterly payments of $500,000 each, beginning in the quarter Clean Coal receives such qualification. NexGen is not obligated to make those payments, but if it does not do so once Clean Coal has qualified for the Section 45 tax credits, it will forfeit a part of its interest in Clean Coal in direct proportion to the amount of the $4.0 million that it elects not to pay, if any.

The deferred income tax benefit for 2008 represents our expected effective tax benefit of approximately 50% for 2008, which is greater than the rate of 31% we recognized for the first quarter of 2007. The increase is primarily the result of larger impact of R&D tax credits for 2008 as compared to the amount estimated for the first quarter of 2007.

Unrealized loss, net of tax, on investments in debt and equity securities amounted to $121,000 for 2008 as compared to a gain of $4,000 for 2007. The recorded unrealized loss in 2008 was the result of the decrease in the market value of our remaining equity investments as compared to a minor increase in 2007.

Liquidity and Capital Resources

We had a positive working capital of $10.0 million at March 31, 2008, compared to working capital of $14.1 million at December 31, 2007. The decrease results primarily from our continued investments in our development projects and fluctuations in operating assets and liabilities in the normal course of business. In addition to working capital, we had long-term investments in securities, accounted for as available-for-sale investments, of approximately $2.8 million both at March 31, 2008 and December 31, 2007. We expect to use a portion of such investments and cash on hand to fund growth of the Company, which is expected to include development projects for AC production and may include expansion of product offerings and strategic acquisitions. We believe that existing and expected future working capital will be sufficient to meet our anticipated operating needs in 2008. We have sufficient resources on hand to continue pursuit of the rapidly growing mercury emission control market. However, we cannot be certain that the positive operating cash flow that we have achieved historically will continue, and it is possible that we could be required to expend some of our current working capital to fund operations, although we consider this unlikely. Our plans for the anticipated future need for expanded AC production will require significant additional funding.

During the first quarter of 2008, we expended an additional $4.0 million, bringing our total costs through March 31, 2008, on our planned AC manufacturing facility to $12.1 million. We are continuing to pursue our plan to build a new AC manufacturing facility, which costs have been deferred and are classified on the balance sheet and included with Development Projects. Such development costs are generally deferred and either (a) expensed when it has been determined they are no longer of future value, or (b) capitalized as part of long-term assets and then subject to future impairment evaluations.

As noted above, we have embarked on an aggressive plan to build a new AC manufacturing facility, which we have previously estimated to have an all-in, total cost of approximately $300 million for a facility with one production line that will be capable of producing approximately 175 million pounds of AC per year, although the selected engineering, procurement and construction, (EPC), contractor is currently updating both cost and schedule for the planned facility. The development plan includes enlisting the support of a strategic partner to participate in 50% of the equity funded project development costs, which we expect will amount to approximately $120 million in total equity funding for the first facility with a single production line. We expect the balance of the project funding, which we estimate to be $180 million, to come from debt financing. We have no binding commitments from any person to provide financing at this time, and we are not certain whether the financing will be available to us as needed on acceptable terms. Our inability to achieve any one of what we currently see to be the critical requirements for the project would likely make it difficult for us to complete the project. We have currently curtailed nonessential spending associated with the project pending confirmation of current cost estimates and schedule, and finalization of certain critical contracts for feedstock supply, engineering, procurement and construction and strategic partner participation.

Our principal source of liquidity is our existing working capital and positive operating cash flow. The continuation of positive cash flow somewhat depends upon our success in maintaining a significant share of the market for mercury control equipment and the continuation of chemical sales and operations for FGC.

Under our defined contribution and 401(k) pension plan, we match up to 7% (in 2008 as compared to 5% in prior years) of salary amounts deferred by employees in the Plan and may contribute certain other amounts as determined annually by our Board of Directors. During the quarters ended March 31, 2008 and 2007, we recognized $32,000, net of forfeitures and $34,000, respectively, of matching expense. This expense is expected to amount to approximately $212,000 in 2008. In the past, we have also made discretionary awards to employees, a portion of which was contributed to the Plan. During the first quarters of 2008 and 2007, we accrued approximately $28,000 and $45,000, respectively, for such payments.

We recorded a net current tax asset of $144,000 and a long term tax asset of $308,000 at March 31, 2008, as compared to a net long term deferred tax asset of $237,000 and net deferred current tax liabilities of ($117,000) on December 31, 2007, respectively. We believe that it is more likely than not that our deferred tax assets will be realized in the future. The change is a result of estimated payments made during the quarter and our anticipated tax benefit which we expect to arise from 2008 activities.

Cash flow used by operations totaled ($866,000) for the first quarter of 2008 compared to ($259,000) for the same period in 2007. The 2008 cash flow used was primarily due to our ACI system activities, which resulted in an increase in deferred revenue and other of $1.4 million, decrease in trade receivables, net of ($2.6) million and an increase in accounts payable of $460,000. Cash flow used from our operating activities included a deferred tax benefit of ($262,000), and our net loss of ($168,000), which was offset by depreciation and amortization of $118,000.

Net cash used by investing activities was $2.4 million for first quarter of 2008 compared to $683,000 for the same period in 2007. The use represents the amounts invested in our development activities to build an AC manufacturing facility of $2.3 million and other capital expenditures of $97,000.

No cash was provided or used in financing activities for the first quarter of either 2008 or 2007. As noted above we expect to require additional debt and equity financing to support future anticipated growth, potential acquisitions and our plans to build AC manufacturing facilities.

Critical Accounting Policies and Estimates

Revenue Recognition   ADA follows the percentage of completion method of accounting for all significant contracts excluding government contracts and chemical sales. The percentage of completion method of reporting income takes into account the estimated costs to complete and estimated gross margin for contracts in progress. We recognize revenue on government contracts based on the time and expenses incurred to date.

Capitalization of Development Costs   We are capitalizing all direct and identifiable incremental costs associated with our development efforts to build an AC facility. Such development costs are generally deferred and either (a) expensed when it has been determined they are no longer of future value, or (b) capitalized as part of long-term assets and then subject to future depreciation expense and impairment evaluations.

Significant estimates are used in preparation of our financial statements and include (1) our allowance for doubtful accounts, which is based on historical experience; (2) our valuation and classification of investments as   available-for-sale   securities, which is based on estimated fair market value; and (3) our percentage of completion method of accounting for significant long-term contracts, which is based on estimates of gross margins and of the costs to complete such contracts. In addition, amounts invoiced for government contracts are subject to change based on the results of future audits by the federal government. We have not experienced significant adjustments in the past, and we do not expect significant adjustments will be required in the future. We also use our judgment to support the current fair value of goodwill and other intangible assets of $2.3 million on the consolidated balance sheets. Management believes the fair value of other recorded intangibles is not impaired, although market demand for our products and services could change in the future, which would require a write-down in recorded values. As with all estimates, the amounts described above are subject to change as additional information becomes available, although we are not aware of anything that would cause us to believe that any material changes will be required in the near term.

Under certain contracts the Company may grant performance guarantees or equipment warranties for a specified period and the achievement of a certain plant operating conditions. In the event the equipment fails to perform as specified, the Company is obligated to correct or replace the equipment. Estimated warranty costs are recorded at the time of sale based on current industry factors. The amount of the warranty liability accrued reflects our best estimate of expected future costs of honoring our obligations under the warranty section of each contract. We believe the accounting estimate related to warranty costs is a critical accounting estimate because: changes in it can materially affect net income; it requires us to forecast the amount of equipment that might fail to perform in the future and require a large degree of judgment.

Income taxes are accounted for under the asset and liability approach. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period when the change is enacted. Deferred tax assets may be reduced by a valuation allowance if and when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The change in laws can have a material effect on the amount of income tax we are subject to. We are not aware of anything that would cause us to believe that any material changes will be required in the near term.

Effective January 1, 2006, we adopted SFAS No. 123R (revised), *Share-Based Payment*, or SFAS 123R, which requires all share-based payments, including grants of stock options, restricted stock units and employee stock purchase rights, to be recognized in our financial statements based upon their respective grant date fair values. Under this standard, the fair value of each employee stock option and employee stock purchase right is estimated on the date of grant using an option pricing model that meets certain requirements. We currently use the Black-Scholes option pricing model to estimate the fair value of our stock options and stock purchase rights. The Black-Scholes model meets the requirements of SFAS 123R but the fair values generated by the model may not be indicative of the actual fair values of our equity awards as it does not consider certain factors important to those awards to employees, such as continued employment and periodic vesting requirements. The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by our stock price and a number of assumptions, including expected volatility, expected life and risk-free interest rate. We use an implied volatility for traded options on our stock as the expected volatility assumption required in the Black-Scholes model. We use a historical volatility rate on our stock options. The fair value of our restricted stock is based on the closing market price of our common stock on the date of grant. If there are any modifications or cancellations of the underlying securities, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. To the extent that we grant additional equity securities to employees or we assume unvested securities in connection with any acquisitions, our stock-based compensation expense will be increased by the additional unearned compensation resulting from those additional grants or acquisitions.

Recently Issued Accounting Policies

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards No. 157 Fair Value Measurements (SFAS 157). SFAS 157 introduces a framework for measuring fair value and expands required disclosure about fair value measurements of assets and liabilities. Currently we have one level I asset which is available for sale securities and they are reported at the fair market value. The impact of adoption had no material impact on our financial statements.

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards No. 159 (SFAS 159) The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is expected to expand the use of fair value measurement, which is consistent with the FASB s long-term measurement objective for accounting for financial instruments. The impact of adoption had no material impact on our financial statements.

In June 2007, the FASB also ratified EITF 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities (EITF 07-3). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007. The impact of adoption had no material impact on our financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. SFAS No. 160 requires the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent s equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income. SFAS No. 160 is effective for fiscal years and fiscal quarters beginning on or after December 15, 2008. We are currently evaluating the impact of this pronouncement on our financial position and results of operations.

In December 2007, the FASB also issued SFAS 141 (revised 2007), Business Combinations , (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, including goodwill, the liabilities assumed and any non-controlling interest in the acquiree. SFAS 141R also establishes disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The impact of adopting SFAS 141R will be dependent on the future business combinations we may pursue after its effective date. Under SFAS 141R, all acquisition costs are expensed as incurred.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure and that such information is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Our CEO and CFO do not expect that our internal controls and procedures will prevent all error and all fraud. Although our internal controls were designed to provide reasonable assurance of achieving their objectives, a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Further, 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 costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any system of controls is also based partly on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 6. Exhibits

10.45	Project Crowfoot Incentive Program Documents (1)**
31.1*	Certification of Chief Executive Officer of ADA-ES, Inc. Pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a)
31.2*	Certification of Chief Financial Officer of ADA-ES, Inc. Pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a)
32.1*	Certification of Chief Executive Officer of ADA-ES, Inc. 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 Chief Financial Officer of ADA-ES, Inc. Pursuant to 18 U.S.C Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Represents a management compensation arrangement.
* These certifications are furnished and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

** Portions of this exhibit have been omitted pursuant to a request for confidential treatment

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ADA-ES, Inc.

Registrant

Date: May 7, 2008 /s/ Michael D. Durham
Michael D. Durham

President and Chief Executive Officer

Date: May 7, 2008 /s/ Mark H. McKinnies
Mark H. McKinnies

Chief Financial Officer

EXHIBIT INDEX

10.45	Project Crowfoot Incentive Program Documents (1)**
31.1*	Certification of Chief Executive Officer of ADA-ES, Inc. Pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a)
31.2*	Certification of Chief Financial Officer of ADA-ES, Inc. Pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a)
32.1*	Certification of Chief Executive Officer of ADA-ES, Inc. 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 Chief Financial Officer of ADA-ES, Inc. Pursuant to 18 U.S.C Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

*These certifications are furnished and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

(1) Represents a management compensation arrangement.
* These certifications are furnished and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

** Portions of this exhibit have been omitted pursuant to a request for confidential treatment