

**Rackwise, Inc. and Subsidiary**  
**Condensed Consolidated Balance Sheets**

	<b>March 31, 2012</b>	<b>December 31, 2011</b>
	<b>(unaudited)</b>	
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 190,167	\$ 613,443
Accounts receivable, net of allowance for factoring fees of \$15,473 and \$3,582, respectively	243,202	212,950
Prepaid expenses and other current assets	118,736	73,564
Total Current Assets	552,105	899,957
Property and equipment, net	298,006	130,072
Intangible assets, net	151,133	162,452
Deposits and other assets	62,313	22,132
Total Assets	\$ 1,063,557	\$ 1,214,613
<b>Liabilities and Stockholders' Deficiency</b>		
Current Liabilities:		
Accounts payable	\$ 1,256,417	\$ 1,072,716
Accounts payable - related parties	10,000	3,090
Due to factor	256,223	179,145
Accrued expenses	1,224,981	1,440,294
Accrued issuable equity	-	1,560,030
Accrued interest - related parties	8,273	7,648
Current portion of notes payable - related parties	50,000	50,000
Current portion of capital lease obligations	3,202	3,815
Current portion of deferred rent	65,934	2,759
Deferred revenues	540,965	525,333
Total Current Liabilities	3,415,995	4,844,830
Deferred rent, non-current portion	112,940	21,650
Total Liabilities	3,528,935	4,866,480
Commitments and Contingencies		
Stockholders' Deficiency:		
Preferred stock, \$0.0001 par value; authorized - 10,000,000 shares; issued and outstanding - none	-	-
Common stock, \$0.0001 par value; authorized - 300,000,000 shares; issued and outstanding - 99,215,472 and 94,863,803 shares, respectively	9,922	9,487
Additional paid-in capital	33,640,235	30,225,066
Accumulated deficit	(36,115,535)	(33,886,420)
Total Stockholders' Deficiency	(2,465,378)	(3,651,867)
Total Liabilities and Stockholders' Deficiency	\$ 1,063,557	\$ 1,214,613

See Notes to these Condensed Consolidated Financial Statements

**Rackwise, Inc. and Subsidiary**  
**Condensed Consolidated Statements of Operations**

(unaudited)

	<b>For The Three Months</b>	
	<b>Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Revenues</b>	\$ 684,149	\$ 536,475
Direct cost of revenues	61,965	48,766
Gross Profit	<u>622,184</u>	<u>487,709</u>
<b>Operating Expenses</b>		
Sales and marketing	909,073	248,148
Research and development	641,112	171,549
General and administrative	1,309,504	563,477
Total Operating Expenses	<u>2,859,689</u>	<u>983,174</u>
Loss From Operations	<u>(2,237,505)</u>	<u>(495,465)</u>
<b>Other Income (Expense)</b>		
Interest, net	(673)	(140,383)
Amortization of debt discount	-	(305,998)
Gain on change in fair value of derivative liabilities	-	42,719
Other income	9,063	-
Total Other Income (Expense)	<u>8,390</u>	<u>(403,662)</u>
<b>Net Loss</b>	<u>\$ (2,229,115)</u>	<u>\$ (899,127)</u>
Net Loss Per Common Share - Basic and Diluted	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>
Weighted Average Number of Common Shares		
Outstanding - Basic and Diluted	<u>95,848,182</u>	<u>40,456,600</u>

See Notes to these Condensed Consolidated Financial Statements

**Rackwise, Inc. and Subsidiary**  
**Condensed Consolidated Statement of Changes in Stockholders' Deficiency**  
**For The Three Months Ended March 31, 2012**

(unaudited)

	<b>Common Stock</b>		<b>Additional Paid-In Capital</b>	<b>Accumulated Deficit</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>			
Balance - January 1, 2012	94,863,803	\$ 9,487	\$ 30,225,066	\$(33,886,420)	\$ (3,651,867)
Issuance of common stock and warrants - private placement, net	4,356,669	436	1,446,678	-	1,447,114
Issuance of accrued equity	145,000	14	1,560,016	-	1,560,030
Issuance of restricted shares as compensation	100,000	10	34,490	-	34,500
Stock-based compensation	-	-	430,960	-	430,960
Cancellation of shares pursuant to settlement agreement	(250,000)	(25)	(56,975)	-	(57,000)
Net loss	-	-	-	(2,229,115)	(2,229,115)
Balance - March 31, 2012	<u>99,215,472</u>	<u>\$ 9,922</u>	<u>\$ 33,640,235</u>	<u>\$(36,115,535)</u>	<u>\$ (2,465,378)</u>

See Notes to these Condensed Consolidated Financial Statements

**Rackwise, Inc. and Subsidiary**  
**Condensed Consolidated Statements of Cash Flows**  
(unaudited)

	For The	
	Three Months Ended March 31,	
	2012	2011
<b>Cash Flows From Operating Activities</b>		
Net loss	\$ (2,229,115)	\$ (899,127)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	20,954	11,353
Amortization of intangible assets	35,571	36,202
Stock-based compensation	465,460	79,637
Cancellation of shares pursuant to settlement agreement	(57,000)	-
Change in fair value of derivative liabilities	-	(42,719)
Amortization of debt discount	-	305,978
Provision for factoring fees	11,891	(146,081)
Deferred rent	154,465	(14)
Changes in operating assets and liabilities:		
Accounts receivable	(42,143)	1,086,011
Prepaid expenses and other current assets	(45,172)	(52,092)
Deposits and other assets	(40,181)	(973)
Accounts payable	183,701	(75,934)
Accounts payable – related parties	6,910	37,873
Due to factor	77,078	(548,713)
Accrued expenses	(215,313)	206,096
Accrued interest – related parties	625	140,144
Deferred revenues	15,632	(243,122)
	<b>572,478</b>	<b>793,646</b>
<b>Total Adjustments</b>		
<b>Net Cash Used in Operating Activities</b>	<b>(1,656,637)</b>	<b>(105,481)</b>
<b>Cash Flows From Investing Activities</b>		
Acquisition of property and equipment	(188,888)	-
Acquisition of intangible assets	(24,252)	(3,188)
	<b>(213,140)</b>	<b>(3,188)</b>
<b>Net Cash Used in Investing Activities</b>		
<b>Cash Flows From Financing Activities</b>		
Proceeds from notes payable	-	63,000
Issuance of common stock and warrants, net [1]	1,447,114	-
Payment of capital lease obligations	(613)	(1,697)
	<b>1,446,501</b>	<b>61,303</b>
<b>Net Cash Provided by Financing Activities</b>		
<b>Net Decrease In Cash</b>	<b>(423,276)</b>	<b>(47,366)</b>
<b>Cash - Beginning</b>	<b>613,443</b>	<b>47,366</b>
<b>Cash - Ending</b>	<b>\$ 190,167</b>	<b>\$ -</b>

[1] Gross proceeds of \$1,633,750, less issuance costs of \$186,636.

**Supplemental Disclosures of Cash Flow Information:**

Non-cash operating and financing activities:

Issuance of accrued equity	\$ 1,560,030	\$ -
Conversion of accrued interest into shares of common stock	\$ -	\$ 2,500

See Notes to these Condensed Consolidated Financial Statements

**Rackwise, Inc. and Subsidiary**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**Note 1 – Organization, Operations, and Basis of Presentation**

Organization and Operations

Rackwise, Inc. and Subsidiary (collectively “Rackwise” or the “Company”), is headquartered in Folsom, California with a software development and data center in Research Triangle, North Carolina. The Company creates Microsoft applications for network infrastructure administrators that provide for the modeling, planning, and documentation of data centers. The Company sells its applications in four primary products: Rackwise Standard Edition, Rackwise Enterprise Edition, Rackwise Data Center Manager and Rackwise Web edition.

On August 24, 2010, Cahaba Pharmaceuticals, Inc., a Nevada corporation formed on August 20, 2010 (“Cahaba”) merged with MIB Digital, Inc., a Florida public corporation formed on September 23, 2009. Cahaba was the survivor in the merger and the principal purpose of the merger was to change the domicile of the company from Florida to Nevada. On July 8, 2011, Cahaba merged with Visual Network Design, Inc., a Nevada corporation. Cahaba was the survivor in the merger, but changed its name in the merger to Visual Network Design, Inc. (“Visual”). On September 29, 2011, Visual merged with Rackwise, Inc., a Nevada corporation formed on September 28, 2011. Visual Network Design, Inc. was the survivor in the merger, but changed its name in the merger to Rackwise, Inc. The sole purpose of the Cahaba to Visual and Visual to Rackwise mergers was to change the Company’s name.

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, such statements include all adjustments (consisting only of normal recurring items) which are considered necessary for a fair presentation of the consolidated financial statements of the Company as of March 31, 2012. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the operating results for the full year. It is recommended that these condensed financial statements be read in conjunction with the financial statements and related disclosures for the year ended December 31, 2011 included in the Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on March 30, 2012.

**Note 2 - Liquidity, Going Concern and Management’s Plans**

The Company has incurred substantial recurring losses since its inception. The Company’s current strategy is to raise capital and invest that capital in such a way that the Company rapidly grows its market share and revenues, eventually resulting in profits and cash from operations. However, this strategy requires a rapid build-up of infrastructure that will initially exacerbate the Company’s operating deficit and use of cash in operations, because the expected revenue expansion will lag the investment in infrastructure. The capital that the Company has raised, and likely will continue to raise, will be used to invest in an expanded salesforce, to fund development of the software product, to fund incremental legal and accounting costs associated with being a public company and to fund the Company’s operating deficit and general working capital requirements.

During the three months ended March 31, 2012 and the twelve months ended December 31, 2011, the Company raised net proceeds of \$1,447,114 (gross proceeds of \$1,633,750 less issuance costs of \$186,636) and \$6,089,753 (gross proceeds of \$6,545,012 less issuance costs of \$455,259), respectively, in a private offering of common stock and warrants. This capital has permitted the Company to proceed with its infrastructure investments. During the three months ended March 31, 2012, the Company hired 14 people, including 11 salespersons, which brought the Company to a full complement of sales staff in the United States and Latin America markets.

As expected, the Company’s net losses and usage of cash has expanded, while it awaits the expected benefits of its investment. During the three months ended March 31, 2012 and 2011, the Company recorded net losses of approximately \$2,229,000 and \$899,000, respectively, while revenues expanded to approximately \$684,000 from \$536,000, respectively. During the three months ended March 31, 2012 and 2011, the Company used cash in operating activities of approximately \$1,657,000 and \$105,000, respectively. As of March 31, 2012, the Company’s cash balance, working capital deficiency, accumulated deficit and stockholders’ deficiency were approximately \$190,000, \$2,864,000, \$36,116,000 and \$2,465,000, respectively. Subsequent to March 31, 2012, the Company raised an additional \$400,000 of gross proceeds from a private offering of convertible promissory notes.

**Rackwise, Inc. and Subsidiary**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**Note 2 - Liquidity, Going Concern and Management's Plans - Continued**

The Company believes it will be successful in these efforts; however, there can be no assurance that it will meet its revenue forecasts or, if necessary, be successful in raising additional debt or equity financing to fund its operations on terms agreeable to the Company. These matters raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary if the Company were unable to continue as a going concern.

**Note 3 – Significant Accounting Policies**

Accounts Receivable and Allowance for Doubtful Accounts

The Company recognizes an allowance for doubtful accounts to ensure that accounts receivable are not overstated due to uncollectibility. At the time accounts receivable are originated, the Company considers a reserve for doubtful accounts based on the creditworthiness of customers. The provision for uncollectible amounts is continually reviewed and adjusted to maintain the allowance at a level considered adequate to cover future losses. The allowance is management's best estimate of uncollectible amounts and is determined based on historical performance that is tracked by the Company on an ongoing basis. During the three months ended March 31, 2012 and 2011, the Company's losses from bad debts were not material. Actual losses could differ materially in the near term from the amounts estimated in determining the allowance.

In addition, the Company also factors its receivables with full recourse and, as a result, accounts for the factoring akin to a secured borrowing, maintaining the gross receivable asset and due to factor liability on its books and records. In connection with the factoring of its receivables, the Company estimates an allowance for factoring fees associated with the collections. These fees range from 2% to 30% depending on the actual timing of the collection. The actual recognition of such fees may differ from the estimates depending upon the timing of collections.

As of March 31, 2012, the Company had three customers representing 51%, 23% and 12% of accounts receivable. As of December 31, 2011, the Company had two customers representing 46% and 46% of accounts receivable.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities, and reported amounts of revenues and expenses in the consolidated financial statements and the accompanying notes. Actual results could differ from those estimates. The significant estimates and assumptions of the Company are stock-based compensation, the useful lives of fixed assets and intangibles, depreciation and amortization, the allowances for factoring fees and income taxes, and the fair value of derivative liabilities and warrants.

Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks. The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the statements of operations. For stock-based derivative financial instruments, the Company uses the binomial lattice options pricing model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period.

Concentration of Credit Risk and Customers

Financial instruments that potentially expose the Company to concentration of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's cash and cash equivalents are deposited with major financial institutions. At times, such deposits may be in excess of the Federal Deposit Insurance Corporation insurable amount. The Company generally does not require collateral from its customers and generally requires payment in 30 days. The Company evaluates the collectability of its accounts receivable and provides an allowance for potential credit losses as necessary. Historically, such losses have been within management's expectations.

**Rackwise, Inc. and Subsidiary**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**Note 3 – Significant Accounting Policies – Continued**

Concentration of Credit Risk and Customers – Continued

Revenues derived from customers in the United Kingdom denominated in U.S. dollars were approximately \$9,000 and \$15,000 during the three months ended March 31, 2012 and 2011, respectively. Revenues derived from customers in Austria denominated in U.S. dollars were approximately \$3,000 and \$0 during the three months ended March 31, 2012 and 2011, respectively. Revenues derived from customers in Australia denominated in U.S. dollars were approximately \$13,000 and \$12,000 during the three months ended March 31, 2012 and 2011, respectively. Revenues derived from customers in Canada denominated in U.S. dollars were approximately \$2,000 and \$3,000 during the three months ended March 31, 2012 and 2011, respectively. Revenues derived from customers in Russia denominated in U.S. dollars were approximately \$0 and \$6,000 during the three months ended March 31, 2012 and 2011, respectively. All remaining revenues were derived from customers in the United States of America. All of the Company's long-lived assets are located in the United States of America. One customer provided 19% and 15% of revenues during the three months ended March 31, 2012 and 2011, respectively.

Intangible Assets

All of the Company's intangible assets consist of shapes acquired from a graphics designer for the Company's database library that are schematics of specific computer equipment. These shapes are utilized in the Company's software with multiple customers in order to enable them to visualize and differentiate the specific computer equipment in their overall network. For example, the Company's software's graphical user interface displays a unique shape for each make and model of computer server. Intangible assets are recorded at cost less accumulated amortization. Amortization is computed using the straight-line method over the estimated useful lives of 2.5 years.

Revenue Recognition

In accordance with ASC topic 985-605, "Software Revenue Recognition," perpetual license revenue is recognized when (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the sales price is fixed or determinable; and (iv) collectability is reasonably assured. Delivery is considered to have occurred when title and risk of loss have been transferred to the customer, which generally occurs after a license key has been delivered electronically to the customer. The Company's perpetual license agreements do not (a) provide for a right of return, (b) contain acceptance clauses or (c) contain refund provisions.

In the case of the Company's (a) subscription-based licenses, and (b) maintenance arrangements, when sold separately, revenues are recognized ratably over the service period. The Company defers revenue for software license and maintenance agreements when cash has been received from the customer and the agreement does not qualify for recognition under ASC Topic 985-605. Such amounts are reflected as deferred revenues in the accompanying financial statements. The Company's subscription license agreements do not (a) provide for a right of return, (b) contain acceptance clauses or (c) contain refund provisions.

The Company provides professional services to its customers. Such services, which include training, installation, and implementation, are recognized when the services are performed. The Company also provides volume discounts to various customers. In accordance with ASC Topic 985-605, the discount is allocated proportionally to the delivered elements of the multiple-element arrangement and recognized accordingly.

For software arrangements with multiple elements, which in its case are comprised of (1) licensing fees, (2) professional services, and (3) maintenance/support, revenue is recognized dependent upon whether vendor specific objective evidence ("VSOE") of fair value exists for separating each of the elements. Licensing rights are generally delivered at time of invoice, professional services are delivered within one to six months and maintenance is for a twelve month contract. Accordingly, licensing revenues are recognized upon invoice, professional services are recognized when all services have been delivered and maintenance revenue is amortized over a twelve month period. The Company determined that VSOE exists for both the delivered and undelivered elements of its multiple-element arrangements. The Company limits its assessment of fair value to either (a) the price charged when the same element is sold separately or (b) the price established by management having the relevant authority. There may be cases, however, in which there is objective and reliable evidence of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In those cases, the selling price method is used to allocate the arrangement consideration, if all other revenue recognition criteria are met. Under the selling price method, the amount of consideration allocated to the delivered item(s) is calculated based on estimated selling prices.

**Rackwise, Inc. and Subsidiary**  
**Notes to Condensed Consolidated Financial Statements**  
**(unaudited)**

**Note 3 – Significant Accounting Policies – Continued**

Revenue Recognition – Continued

The Company manages the business as a single segment, but it has revenues from multiple sources.

Fair Value of Financial Instruments

The carrying amounts of financial instruments, including cash and cash equivalents, receivables, accounts payable, accrued expenses and deferred revenue, approximated fair value as of the balance sheet date presented, because of the relatively short maturity dates on these instruments. The carrying amounts of the financing arrangements issued approximated fair value as of the balance sheet date presented, because interest rates on these instruments approximate market interest rates after consideration of stated interest rates, anti-dilution protection and associated warrants.

Debt Discount and Amortization of Debt Discount

Debt discount represents the fair value of embedded conversion options of various convertible debt instruments and attached convertible equity instruments issued in connection with debt instruments. The debt discount is amortized over the earlier of (i) the term of the debt or (ii) conversion of the debt, using the straight-line method which approximates the interest method. The amortization of debt discount is included as a component of other expenses in the accompanying statements of operations.

Stock-Based Compensation

The Company has an equity plan which allows for the granting of stock options to its employees, directors and consultants for a fixed number of shares with an exercise price equal to the fair value of the shares at date of grant. The Company measures the cost of services received in exchange for an award of equity instruments based on the fair value of the award. For employees and directors, the fair value of the award is measured on the grant date and for non-employees, the fair value of the award is generally re-measured on interim financial reporting dates until the service period is complete. The fair value amount is then recognized over the period during which services are required to be provided in exchange for the award, usually the vesting period. Since the shares underlying the Company's equity are not currently registered, the fair value of the Company's restricted equity instruments was estimated based on historical observations of cash prices paid for the Company's restricted common stock.

Stock-based compensation for directors is reflected in general and administrative expenses in the consolidated statements of operations. Stock-based compensation for employees and consultants could be reflected in (a) sales and marketing expenses; (b) research and development expenses; or (c) general and administrative expenses in the consolidated statements of operations.

Net Loss Per Common Share

Basic net loss per share is computed by dividing the net loss applicable to common shares by the weighted average number of common shares outstanding during the period. Weighted average shares outstanding for the three months ended March 31, 2012 excludes the weighted average impact of the 3,000,000 escrowed shares. Weighted average shares outstanding for the three months ended March 31, 2011 includes the weighted average underlying shares exercisable with respect to the 1,609,747 warrants exercisable at prices of \$0.01 per share or less. In accordance with the accounting literature, (1) the Company has given effect to the issuance of these warrants in computing basic net loss per share because the underlying shares are issuable for little or no cash consideration; and (2) the Company has excluded the impact of the escrowed shares because they are contingently returnable. Diluted net loss per common share adjusts basic net loss per common share for the effects of potentially dilutive financial instruments, only in the periods in which such effects exist and are dilutive. At March 31, 2012, outstanding stock options and warrants to purchase 23,275,000 and 49,815,183 shares of common stock were excluded from the calculation of diluted net loss per common share because their impact would have been anti-dilutive. At March 31, 2011, outstanding stock options and warrants to purchase 13,575,986 and 11,889,752 shares of common stock, respectively, were excluded from the calculation of diluted net loss per common share because their impact would have been anti-dilutive.

**Rackwise, Inc. and Subsidiary**  
**Notes to Condensed Consolidated Financial Statements**  
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**Note 4 – Derivative Liabilities – Related Parties**

In accordance with ASC 815-40, “*Derivatives and Hedging - Contracts in Entity's Own Equity*”, instruments which do not have fixed settlement provisions are deemed to be derivative instruments. The Company has determined that embedded conversion options of various notes payable which do not have fixed settlement provisions and accordingly are not indexed to its own stock, are deemed to be derivative liabilities. The embedded conversion options of the various notes issued by the Company do not have fixed settlement provisions as the conversion and exercise prices are not fixed and determinable on the date of issuance. In accordance with ASC Topic 718, “*Stock Compensation*” (“ASC 718”), the conversion options of the notes were bifurcated from their respective host contracts and recognized as derivative liabilities. The warrants issued in connection with the notes payable were not deemed to be derivative liabilities because they have a fixed settlement provision. The fair values of these derivative liabilities are re-measured at the end of every reporting period with the change in value reported in the statement of operations.

The fair values of the embedded conversion options, which are associated with notes payable issued to related parties, were measured using the binomial lattice options pricing model with the following assumptions:

	For The Three Months Ended March 31, 2011
Risk free rate	0.10% - 0.17%
Expected volatility	65% - 70%
Expected life (in years)	0.13 - 0.38
Expected dividend yield	0%

The risk-free interest rate was based on the rates of treasury securities with the same terms as the terms of the instruments. The Company based expected volatility on the historical volatility for ten comparable publicly traded company's common stock. The expected life of the notes was based on the maturity of the notes. The expected dividend yield of zero was based upon the fact that the Company has not historically paid dividends, and does not expect to pay dividends in the future. The gain on change in fair value of derivative liabilities, included in other income in the accompanying statements of operations was \$42,719 for the three months ended March 31, 2011.

On September 21, 2011, immediately prior to, and conditioned upon the effectiveness of the reverse merger, all of the outstanding non-bridge convertible notes and the related accrued interest converted into equity. At that time the derivative liability associated with the embedded conversion options of notes issued to related parties was revalued at \$1,133,186 and was reclassified to equity.

**Rackwise, Inc. and Subsidiary**  
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## **Note 5 – Equity**

### Consulting Agreements

On August 21, 2011, the Company entered into a three-month agreement for public relations and financial communications services. In consideration of services to be rendered, the Company agreed to pay \$15,000 in cash per month in advance, for an aggregate of \$45,000, and, subject to the consummation of the reverse merger, to issue 70,000 shares of vested Company common stock per month, for an aggregate of 210,000 shares, of which, 70,000 shares remained unissued as of December 31, 2011. Accordingly, during 2011, the Company accrued the equity issuance liability of \$15,960. During the three months ended March 31, 2012, the remaining 70,000 shares were issued and the \$15,960 issuance date value of the shares was credited to equity.

On December 19, 2011, the Company renewed an agreement for public relations and financial communications services for a three-month term. In consideration of services to be rendered, the Company agreed to pay \$7,500 in cash per month in advance, for an aggregate of \$22,500, and to issue 25,000 shares of vested Company common stock per month, for an aggregate of 75,000 shares. On February 3, 2012, after the Company had made an initial cash payment of \$7,500 in December 2011, the Company terminated this agreement for non-performance. No shares were issued and no stock-based compensation expense was recorded related to this renewal agreement.

On November 16, 2011, the Company entered into a twelve-month agreement for investor relations services with a consultant. In consideration of services to be rendered, the Company agreed to pay \$6,000 in cash per month in advance, for an aggregate of \$72,000, and to immediately issue 500,000 shares of vested Company common stock, plus an additional 500,000 shares of common stock at the six month anniversary of the agreement. The Company valued the shares and recorded the full value of issued shares and cash payments as consulting expense at the issuance date. For the year ended December 31, 2011, the Company recorded stock-based compensation expense of \$114,000 (value of the first 500,000 shares), included in general and administrative expenses in the accompanying statements of operations. On January 11, 2012, the Company terminated this agreement and on January 16, 2012, the Company entered into a settlement agreement whereby the consultant agreed to accept the initial \$12,000 of 2011 cash payments and 250,000 shares of common stock (by returning 250,000 shares of common stock to the Company for cancellation) in full satisfaction of the terminated agreement. The Company reversed \$57,000 of stock-based compensation expense upon cancellation of the returned shares.

On November 30, 2011, the Company entered into a six-month agreement for investor relations services. In consideration of services to be rendered, the Company agreed to pay a minimum of \$7,000 in cash per month in advance (subject to supplemental performance-based bonuses), for an aggregate of \$42,000, and to immediately issue 75,000 shares of vested Company common stock, of which, 75,000 shares remained unissued as of December 31, 2011. Accordingly, during 2011, the Company accrued the equity issuance liability of \$17,100. During the three months ended March 31, 2012, the remaining 75,000 shares were issued and the \$17,100 issuance date value of the shares was credited to equity.

### Second Private Offering

During the three months ended March 31, 2012, the Company had three additional closings of a private offering that commenced in December 2011 (the "Second Private Offering") pursuant to which an aggregate of 4,356,669 investor units ("Second Units") were sold at a price of \$0.375 per Second Unit, resulting in \$1,447,114 of aggregate net proceeds (\$1,633,750 of gross proceeds less \$186,636 of issuance costs). Each Second Unit consists of one share of common stock (deemed to represent \$0.345 of the per Second Unit cost) and a warrant to purchase one-quarter share of common stock (deemed to represent \$0.030 of the per Second Unit cost) (the "Second Investor Warrants"), such that an aggregate of 4,356,669 shares of common stock and Second Investor Warrants to purchase 1,089,169 shares of common stock were issued.

The Second Private Offering was made on a "best efforts" basis with respect to a maximum of 8,000,000 Second Units (\$3,000,000 of aggregate proceeds). In addition, in the event the maximum number of Second Units was sold, the placement agent and the Company had the option to offer an additional 2,666,667 Second Units (\$1,000,000 of aggregate proceeds).

**Rackwise, Inc. and Subsidiary**  
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**Note 5 – Equity**

Second Private Offering – Continued

The Second Investor Warrants are exercisable for a period of five years at an exercise price of \$1.00 per full share of common stock. The Second Investor Warrants may be called for redemption by the Company at any time upon not less than 30 or more than 60 days prior written notice, provided that, at the time of delivery of such notice, (i) there is a registration statement covering the resale of the shares underlying the warrants; (ii) the average closing bid price for the Company's common stock for each of the 20 consecutive trading days prior to the date of the notice of redemption is at least \$2.00, as proportionally adjusted to reflect any stock splits, stock dividends, combinations of shares or like events; and (iii) the average trading volume for the Company's common stock is at least 100,000 shares per day during the 20 consecutive trading days prior to the date of the notice of redemption and that during such 20-day period there is no more than one trading day in which there is no trading in the Company's common stock.

The Second Investor Warrants, at the option of the holder, may be exercised by cash payment of the exercise price to the Company. Alternatively, the Second Investor Warrants may be exercised on a cashless basis commencing one year after the date of the final closing of the Second Private Offering if no registration statement registering the shares underlying the investor warrants is then in effect. The exercise price and number of shares of common stock issuable on exercise of the investor warrants may be adjusted in certain circumstances including stock splits, stock dividends, and future issuances of the Company's equity securities without consideration or for consideration per share less than \$0.375 (as specified in the warrant agreement).

The placement agent for the Second Private Offering receives a cash commission of 10% or 5% of the funds raised from investors in the Second Private Offering that were directly attributable or referred to the placement agent, respectively. In addition, the placement agent receives five-year warrants to purchase shares of common stock (the "Second Broker Warrants") equal to 10% or 5% of the Second Units sold to investors in the Second Private Offering that were directly attributable or referred to the placement agent, respectively. As a result of the foregoing arrangement, in connection with the three 2012 closings, the placement agent (1) was paid aggregate cash commissions of \$136,500; and (2) was issued Second Broker Warrants to purchase 364,000 shares of common stock.

The Second Broker Warrants are identical to the Second Investor Warrants in all material respects except that (i) the resale of the common stock underlying them is not covered by a registration statement; and (ii) they have an exercise price of \$0.375 per share of common stock.

In connection with the Second Private Offering, the Company executed a registration rights agreement, whereby the Company committed to file a registration statement covering the resale of the common stock underlying the Second Units sold or to be sold in the Second Private Offering and the common stock that is issuable upon exercise of the Second Investor Warrants (but not the common stock that is issuable upon exercise of the Second Broker Warrants) within 75 days of the final closing of the Second Private Offering, and to use commercially reasonable efforts to cause the registration statement to become effective no later than 150 days after it is filed. The Company will be liable for monetary penalties at the monthly rate of 1% (to a maximum of 10%) of each holder's investment in the Second Private Offering until the failure to meet the above deadlines are cured or upon the occurrence of certain other specified events. Notwithstanding the foregoing, no payments shall be owed with respect to that portion of a holder's registrable securities (1) which may be sold by such holder under Rule 144 or pursuant to another exemption from registration; or (2) which the Company is unable to register due to limits imposed by Rule 415 under the Securities Act (which shares would then be eligible for "piggyback" registration rights with respect to any registration statement filed by the Company following the effectiveness of the original registration statement). On January 17, 2012, the Company filed a registration statement on Form S-1 that included the Second Private Offering registrable securities.

Stock Warrants

During the three months ended March 31, 2011, the Company issued warrants to purchase 50,654 shares of common stock at an exercise price of \$0.252 per share for a term of five years to two related party note holders in connection with the issuance of convertible notes payable aggregating \$63,000 in principal amount (see Note 6 – Related Party Transactions). Using the binomial lattice options pricing model, the Company determined that the relative fair value of the warrants was \$4,750. The fair value was recorded as a debt discount and amortized over the term of the notes. The assumptions used in the binomial lattice options pricing model were as follows: risk-free rate of 1.77%; expected volatility of 70.0%; expected term of 4.2 years; expected dividend yield of 0%.

**Rackwise, Inc. and Subsidiary**  
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**Note 5 – Equity – Continued**

Stock Warrants - Continued

During the three months ended March 31, 2012, the Company issued warrants to purchase an aggregate of 1,453,169 shares of common stock at a weighted average exercise price of \$0.843 per share. As of March 31, 2012, there were 49,815,138 outstanding and exercisable stock warrants with a weighted average exercise price of \$0.634 per share, a weighted average remaining contractual life of 4.76 years and \$96,140 of intrinsic value. The intrinsic value is calculated on the difference between the fair market value of the Company's restricted stock, which was \$0.345 per share as of March 31, 2012, and the exercise price of the warrants.

Stock Options

During the three months ended March 31, 2011, the Company granted no stock options.

During the three months ended March 31, 2012, the Company granted to its directors, officers, employees and consultants ten-year options to purchase an aggregate of 23,275,000 shares of the Company's common stock at an exercise price of \$0.345 per share, of which 12,475,000 were granted under the Company's 2011 Equity Incentive Plan (the "2011 Plan") and the remaining 10,800,000 (of which 6,900,000 were granted to the new CEO) were not granted pursuant to an established plan. The options vest as follows: (i) an option to purchase 6,900,000 shares of common stock granted to the new CEO vested on an accelerated basis in November 2011 based on the new CEO meeting specified performance criteria; (ii) an option to purchase 2,500,000 shares of common stock vests one-third immediately, one-third on September 21, 2012 and one-third on September 21, 2013; (iii) options to purchase an aggregate of 13,325,000 shares of common stock vest one-third 0.7-1.0 years from the date of grant, one-third 1.7-2.0 years from the date of grant and one-third 2.7-3.0 years from the date of grant; and (iv) options to purchase an aggregate of 550,000 shares of common stock vest ratably on a quarterly basis over a three-year term.

The aggregate grant date value of approximately \$5,090,000 will be recognized proportionate to the vesting terms. The weighted average estimated fair value of the stock options granted during the three months ended March 31, 2012 was \$0.22 per share. The weighted average assumptions used in the Black-Scholes option pricing model were as follows: risk-free rate of 1.03%; expected volatility of 75.0%; expected term of 5.79 years; expected dividend yield of 0%. In March 2012, the Compensation Committee of the Company's Board of Directors determined that the New CEO's options became fully vested effective November 2011 as a result of the execution of a strategic alliance with a major customer. Although the option was not formally granted prior to December 31, 2011, the New CEO had a contractual right to the vested options pursuant to his employment agreement, and, accordingly, the Company accrued the equity issuance liability of \$1,526,970 at December 31, 2011 based on the full value of the option as of December 31, 2011, when the restricted stock was valued at \$0.345 per share. On January 9, 2012, the New CEO's options were issued and the \$1,444,170 issuance date value of the options was credited to equity. The weighted average assumptions used in the Black-Scholes option pricing model were as follows: risk-free rate of 0.85%; expected volatility of 75.0%; expected term of 5.00 years; expected dividend yield of 0%.

The risk-free interest rate was based on rates of treasury securities with the same expected term as the options. Expected volatility is based on implied volatilities from similar companies that operate within the similar industry sector index. The Company calculated the historical volatility for each comparable company to come up with an expected average volatility and then adjusted the expected volatility based on factors such as historical stock transactions, major business transactions, and industry trends. The expected terms of the options are estimated based on factors such as vesting periods, contractual expiration dates and historical exercise behavior. The expected dividend yield was based upon the fact that the Company has not historically paid dividends, and does not expect to pay dividends in the future.

During the three months ended March 31, 2012 and 2011, the overall stock-based compensation expense recorded by the Company associated with options was \$430,960 and \$79,637, respectively. These amounts have been included in operating expenses in the accompanying statements of operations. As of March 31, 2012, there was \$3,131,626 unrecognized stock-based compensation expense that will be amortized over a weighted average period of 2.5 years. As of March 31, 2012, there were 23,275,000 outstanding stock options with a weighted average exercise price of \$0.345 per share, a weighted average remaining contractual life of 9.8 years and no intrinsic value. As of March 31, 2012, there were 7,733,333 exercisable stock options with a weighted average exercise price of \$0.345 per share, a weighted average remaining contractual life of 9.8 years and no intrinsic value.

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**Note 6 – Related Party Transactions**

The Company was obligated to pay management fees to a stockholder of \$10,000 per month for general business consulting, which represented \$30,000 for the three months ended March 31, 2011. This agreement was terminated in September 2011.

On January 1, 2012, the Company entered into a new agreement with the stockholder to provide financial advisory services to the Company. The Company agreed to pay fees of \$10,000 per month for twelve months, as well as a one-time fee of \$40,000, which represented \$70,000 for the three months ended March 31, 2012.

The Company was obligated to pay financing fees to a stockholder equal to 10% of the proceeds from note issuances (see Note 5 – Equity – Stock Warrants for information about the related warrant issuances) to another related party. During the three months ended March 31, 2011, the Company issued \$60,000 of notes to the other related party and issued \$3,000 of notes to the stockholder and accrued another \$3,000 fee to satisfy the financing fee obligation.

**Note 7 - Accrued Expenses**

Accrued expenses consist of the following:

	<u>March 31,</u> 2012	<u>December 31,</u> 2011
	(unaudited)	
Accrued commissions	\$ 140,606	\$ 164,123
Accrued payroll	337,704	328,942
Accrued payroll taxes(1)	519,135	537,289
Accrued vacation	163,966	150,207
Accrued professional fees	<u>63,570</u>	<u>259,733</u>
Total accrued expenses	<u>\$ 1,224,981</u>	<u>\$ 1,440,294</u>

(1) Includes accrual for interest and penalties.

Accrued expenses include liabilities for unpaid payroll taxes along with an estimate of related interest and penalties. In 2011, the IRS placed Federal tax liens aggregating approximately \$502,000 against the Company in connection with these unpaid payroll taxes. The Company is currently in discussions with the IRS to implement an installment payment plan.

**Note 8 – Commitments and Contingencies**

Employment Agreements

The Company hired a new Chief Financial Officer (the “New CFO”) on January 23, 2012. In connection with his appointment, the New CFO received (i) an annual base salary of \$175,000; (ii) eligibility for bonus compensation; (iii) an option to purchase 1,000,000 shares of the Company’s common stock, vesting over a period of three years, under the 2011 Plan, exercisable at a price of \$0.345 per share; and (iv) 100,000 shares of the Company’s restricted common stock with a grant date of \$34,500, which was recognized immediately. In addition, in the event that the New CFO was terminated without reasonable cause, he would be entitled to a severance payment equal to six months of his base salary at the time of termination. On February 15, 2012, the New CFO was granted an option to purchase 500,000 shares of the Company’s common stock, vesting over a period of three years, under the 2011 Plan, exercisable at a price of \$0.345 per share. Both of the New CFO’s options are included in the above “Option Grants” discussion.

Operating Lease

The Company leases facilities in Folsom, California, Las Vegas, Nevada and Raleigh, North Carolina under non-cancelable operating leases. For the three months ended March 31, 2012 and 2011, rent expense was \$61,359 and \$74,306, respectively, and was recorded as part of general and administrative expenses within the statements of operations.

**Rackwise, Inc. and Subsidiary**  
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**Note 8 – Commitments and Contingencies – Continued**

Operating Lease – Continued

In January 2012, the Company executed a 63-month lease for 3,465 square feet of new headquarters office space in Folsom, California. The lease commenced on March 30, 2012. The base rent commences at \$6,757 per month and escalates to \$7,833 per month over the lease term. The Company is entitled to pay no base rent during each of the 13th, 26th, and 39th months of the lease.

In February 2012, the Company executed a 37-month sub-lease for the remaining terms of its Las Vegas, Nevada office space. The sub-lease rent income commences at \$8,983 per month and escalates to \$9,818 per month over the lease term. During the three months ended March 31, 2012, the Company recognized a charge of \$155,000, included in general and administrative expense in the accompanying statements of operations, representing the aggregate differential between the lease expense and sublease income over the life of the leases.

In February 2012, the Company executed a new five-year lease for 5,772 square feet of office space in Raleigh, North Carolina. The base rent commences at \$7,922 per month and escalates to \$11,073 per month over the lease term. The landlord is spending up to \$132,760 on leasehold improvements in order to prepare the space for occupancy and the lease has not yet commenced. The lease contains an option which permits the Company to terminate the lease on January 31, 2015, provided that the Company pay \$102,795 and provide nine months written advance notice.

Future minimum payments (exclusive of the benefit of the Las Vegas sublease income) at March 31, 2012 required under the operating leases are as follows:

Years ending March 31:	
2013	\$ 338,953
2014	365,255
2015	451,610
2016	81,216
2017	91,257
Thereafter	<u>23,499</u>
	<u>\$ 1,351,790</u>

**Note 9 – Subsequent Events**

Subsequent Events

The Company evaluates events that have occurred after the balance sheet date but before the financial statements are issued. Based upon the evaluation, the Company did not identify any recognized or non-recognized subsequent events that would have required further adjustment or disclosure in the consolidated financial statements.

Convertible Promissory Note Issuance

On April 20, 2012, the Company completed and closed an offering of 12% Senior Convertible Promissory Notes in which it sold an aggregate principal amount of \$400,000 in notes to four persons. Each of the notes matures 90 days after issuance and is convertible, at the option of the holder, into Company units, at a price of \$0.45 per unit, each unit consisting of one share of the Company's common stock and one warrant representing the right to purchase one share of the Company's common stock for a period of five years from issuance at an exercise price of \$1.00 per share. The warrants will be exercisable on a cashless basis and will contain weighted average anti-dilution price protection.

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**Note 9 – Subsequent Events – Continued**

Option Grants

Subsequent to March 31, 2012, the Company committed to offer ten-year options under the 2011 Plan to purchase an aggregate of up to 550,000 shares of the Company's common stock to two new employees, with the exercise date to be determined on the date of grant. The options will vest ratably on an annual basis over a three-year term.

Subsequent to March 31, 2012, the Company committed to offer ten-year options, not pursuant to the 2011 Plan, to purchase 500,000 shares of the Company's common stock to two new advisory board members, with the exercise date to be determined on the date of grant. The options vest ratably on a quarterly basis over a three-year term.

Consulting Agreement

In April 2012, the Company amended a consulting services agreement pursuant to which, among other things, the Company agreed to issue seven-year warrants to purchase an additional 500,000 shares of the Company's common stock at an exercise price of \$1.00 per share. The Company also agreed to pay a cash fee of \$100,000 on or before April 30, 2012.