

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

AETHLON MEDICAL INC
Form 10QSB
February 14, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934.

For the quarterly period ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934.

For the transition period from _____ to _____

COMMISSION FILE NUMBER 0-21846

AETHLON MEDICAL, INC.

(Exact name of registrant as specified in its charter)

NEVADA

(State or other jurisdiction of
incorporation or organization)

13-3632859

(I.R.S. Employer
Identification No.)

3030 BUNKER HILL ST, SUITE 4000, SAN DIEGO, CA

92109

(Address of principal executive offices)

(Zip Code)

(858) 459-7800

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .

The number of shares of common stock of the registrant outstanding was 28,382,529 as of February 8, 2007.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONDENSED CONSOLIDATED BALANCE SHEET AT DECEMBER 31, 2006

3

1

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED DECEMBER 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2006	4
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED DECEMBER 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2006	5
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS	6
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION	15
ITEM 3. CONTROLS AND PROCEDURES	19
PART II. OTHER INFORMATION	
ITEM 1. LEGAL PROCEEDINGS	20
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	20
ITEM 3. DEFAULTS UPON SENIOR SECURITIES	20
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	21
ITEM 5. OTHER INFORMATION	21
ITEM 6. EXHIBITS	21

2

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AETHLON MEDICAL, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED BALANCE SHEET
December 31, 2006
(Unaudited)

ASSETS	
Current assets	
Cash	\$ 44,315
Prepaid expenses	17,431

	61,746
Property and equipment, net	12,449
Patents and patents pending, net	138,778
Other assets	13,200

	\$ 226,173
	=====

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current Liabilities	
Accounts payable and accrued liabilities	\$ 1,040,611
Due to related parties	1,107,513
Notes payable, net of discount	502,500
Convertible notes payable, net of discount	279,016
	2,929,640
Commitments and Contingencies	
Stockholders' Deficit	
Common stock, par value \$0.001 per share; 50,000,000 shares authorized; 27,670,375 shares issued and outstanding	27,670
Additional paid-in capital	21,127,046
Deferred consulting fees	(8,167)
Deficit accumulated during development stage	(23,850,016)
	(2,703,467)
	\$ 226,173

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

3

AETHLON MEDICAL, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Nine Months Ended December 31, 2006 and 2005 and
the Period January 31, 1984 (Inception) Through December 31, 2004
(Unaudited)

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005	Nine Months Ended December 31, 2006	
	-----	-----	-----	
REVENUES				
Grant income	\$ --	\$ --	\$ --	\$ --
Subcontract income	--	--	--	--
Sale of research and development	--	--	--	--
	-----	-----	-----	
	--	--	--	
EXPENSES				
Professional Fees	133,316	221,022	499,964	
Payroll and related	220,539	164,955	611,816	

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

General and administrative	111,139	108,037	392,647
Impairment	--	--	--
	-----	-----	-----
	464,994	494,014	1,504,427
	-----	-----	-----
OPERATING LOSS	(464,994)	(494,014)	(1,504,427)
	-----	-----	-----
OTHER EXPENSE (INCOME)			
Change in fair value of warrant liability	--	--	--
Interest and other debt expenses	75,765	100,361	283,142
Interest income	--	--	--
Other	--	--	--
	-----	-----	-----
	75,765	100,361	283,142
	-----	-----	-----
NET LOSS	\$ (540,759)	\$ (594,375)	\$ (1,787,569)
	=====	=====	=====
BASIC AND DILUTED LOSS PER			
COMMON SHARE	\$ (0.02)	\$ (0.03)	\$ (0.07)
	=====	=====	=====
WEIGHTED AVERAGE NUMBER OF COMMON			
SHARES OUTSTANDING	27,174,574	19,486,094	27,174,574
	=====	=====	=====

The accompanying notes are an integral part of these unaudited condensed consolidated financial s

4

AETHLON MEDICAL, INC.
(A DEVELOPMENT STAGE COMPANY)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED DECEMBER 31, 2006 AND 2005 (Unaudited)
FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2004
(Unaudited)

	NINE MONTHS ENDED DECEMBER 31, 2006 (UNAUDITED)	NINE MONTHS ENDED DECEMBER 31, 2005 (UNAUDITED)
	-----	-----
Cash flows from operating activities:		
Net loss	\$ (1,787,569)	\$ (1,787,569)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	21,256	21,256
Amortization of deferred consulting fees	36,750	36,750
Gain on sale of property and equipment	--	--
Gain on settlement of debt	--	--
Loss on settlement of accrued legal liabilities	--	--
Stock based compensation	23,816	23,816
Fair market value of warrants issued in connection with accounts payable and debt	--	--
Fair market value of common stock, warrants	--	--

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

and options issued for services and interest	195,358	
Change in fair value of warrant liability	--	
Amortization of debt discount	136,651	
Impairment of patents and patents pending	--	
Impairment of goodwill	--	
Deferred compensation forgiven	--	
Changes in operating assets and liabilities:		
Prepaid expenses	14,791	
Other assets	4,000	
Accounts payable and accrued liabilities	178,588	
Due to related parties	(108,000)	
	-----	-----
Net cash used in operating activities	(1,284,359)	(
	-----	-----
Cash flows from investing activities:		
Purchases of property and equipment	(14,454)	
Patents and patents pending	(3,252)	
Proceeds from the sale of property and equipment	--	
Cash of acquired company	--	
	-----	-----
Net cash used in investing activities	(17,706)	
	-----	-----
Cash flows from financing activities:		
Proceeds from the issuance of notes payable	--	
Principal repayments of notes payable	--	
Proceeds from the issuance of convertible notes payable	50,000	
Proceeds from the issuance of common stock	460,003	
Professional fees related to registration statement	--	
	-----	-----
Net cash provided by financing activities	510,003	
	-----	-----
Net (decrease)increase in cash	(792,062)	
Cash at beginning of period	836,377	
	-----	-----
Cash at end of period	\$ 44,315	\$
	=====	=====

The accompanying notes are an integral part of these unaudited condensed consolidated

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

NOTE 1. NATURE OF BUSINESS AND BASIS OF PRESENTATION

Aethlon Medical, Inc. (the "Company") is a development stage therapeutic device company focused on expanding the applications of its Hemopurifier (R) platform technology, which is designed to rapidly reduce the presence of infectious viruses and other toxins from human blood. In this regard, the Company's core focus is the development of pathogens targeted as potential biological warfare agents, HIV/AIDS, and Hepatitis C. In pre-clinical testing, the Company has published that its HIV-Hemopurifier(R) removed 55% of HIV from human blood in three hours and in excess of 85% of HIV in twelve hours. Additionally, the HIV-Hemopurifier(R) captured 90% of gp120, a toxic protein that depletes human immune cells, during a one-hour pre-clinical blood study.

The Hemopurifier(R) is in the development stage and significant research and testing are still needed to reach commercial viability. Any resulting medical device or process will require approval by the U.S. Food and Drug Administration ("FDA"), and the Company has not yet begun efforts to obtain FDA approval and such approval may take several years.

The Company is classified as a development stage enterprise under accounting principles generally accepted in the United States of America ("GAAP") and has not generated revenues from its principal operations.

The Company's common stock is quoted on the Over-the-Counter Bulletin Board of the National Association of Securities Dealers under the symbol "AEMD.OB".

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with GAAP for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended December 31, 2006 are not necessarily indicative of the results that may be expected for the year ending March 31, 2007. For further information, refer to the Company's Annual Report on Form 10-KSB for the year ended March 31, 2006, which includes audited financial statements and footnotes as of March 31, 2006 and for the years ended March 31, 2005 and 2006.

NOTE 2. GOING CONCERN AND LIQUIDITY CONSIDERATIONS

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. The Company has experienced cumulative losses of \$23,850,016 for the period from January 31, 1984 (Inception) through December 31, 2006. The Company has not generated significant revenue or any profit from operations since inception. A substantial amount of additional capital will be necessary to advance the development of the Company's products to the point at which they may become commercially viable. The Company's current plan of operation is to fund the Company's research and development activities and operations for the near future utilizing its existing financial agreement with Fusion Capital Fund II, LLC ("Fusion Capital"). Through December 31, 2006 the Company had received \$1,905,001 and has \$4,094,999 remaining available from this agreement. However, no assurance can be given that we will receive any additional funds under our agreement with Fusion Capital. Based on our projections of additional resources required to complete research, development and testing associated with our Hemopurifier(R) products, we anticipate that these funds will satisfy our cash requirements, including this anticipated increase in operations, in excess of the next twelve months.

Based on the Company's projections of working capital required for operations and to complete research, development and testing associated with its

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Hemopurifier(R) products, the Company anticipates that these funds will satisfy its cash requirement in excess of the next twelve months. No assurance can be given that the Company will receive any additional funds under its agreement with Fusion Capital. However, due to market conditions, and to assure availability of funding for operations in the long term, the Company may arrange for additional funding, subject to acceptable terms, during the next twelve months.

The condensed consolidated financial statements do not include any adjustments relating to the recoverability of assets that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to obtain additional financing as may be required, and to generate sufficient revenue and operating cash flow to meet its obligations on a timely basis.

NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The summary of significant accounting policies of the Company presented below is designed to assist the reader in understanding the Company's condensed consolidated financial statements. Such financial statements and related notes are the representations of Company management, who is responsible for their integrity and objectivity. These accounting policies conform to GAAP in all material respects, and have been consistently applied in preparing the accompanying condensed consolidated financial statements.

6

PRINCIPLES OF CONSOLIDATION

The accompanying condensed consolidated financial statements include the accounts of Aethlon Medical, Inc. and its legal wholly-owned subsidiaries Aethlon, Inc., Hemex, Inc. and Cell Activation, Inc. (collectively hereinafter referred to as the "Company"). These subsidiaries are dormant and there are no material intercompany transactions or balances.

LOSS PER COMMON SHARE

Loss per common share is based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "EARNINGS PER SHARE."

Securities that could potentially dilute basic loss per share (prior to their conversion, exercise or redemption) were not included in the diluted-loss-per-share computation because their effect is anti-dilutive. There were 7,450,773 and 10,306,406 potentially dilutive common shares outstanding for the three and nine months ended December 31, 2006, respectively. There were 8,515,903 and 4,812,924 potentially dilutive common shares outstanding for the three and nine months ended December 31, 2005, respectively.

PATENTS

The Company capitalizes the cost of patents, some of which were acquired, and amortizes such costs over the shorter of the remaining legal life or their estimated economic life.

RESEARCH AND DEVELOPMENT EXPENSES

The Company incurred approximately \$308,120 and \$635,235 of research and

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

development expenses during the nine months ended December 31, 2006 and 2005, respectively. For the fiscal quarters ended December 31, 2006 and 2005, the Company incurred research and development expenses of approximately \$144,301 and \$156,947, respectively.

EQUITY INSTRUMENTS FOR SERVICES

The Company follows SFAS No. 123-R (as interpreted by Emerging Issues Task Force ("EITF") Issue No. 96-18, "ACCOUNTING FOR EQUITY INSTRUMENTS THAT ARE ISSUED TO OTHER THAN EMPLOYEES FOR ACQUIRING, OR IN CONJUNCTION WITH SELLING, GOODS OR SERVICES") ("EITF No. 96-18") to account for transactions involving goods and services provided by third parties where the Company issues equity instruments as part of the total consideration. Pursuant to paragraph 7 of SFAS No. 123-R, the Company accounts for such transactions using the fair value of the consideration received (i.e. the value of the goods or services) or the fair value of the equity instruments issued, whichever is more reliably measurable.

The Company applies EITF No. 96-18, in transactions, when the value of the goods and/or services are not readily determinable and (1) the fair value of the equity instruments is more reliably measurable and (2) the counterparty receives equity instruments in full or partial settlement of the transactions, using the following methodology:

- (a) For transactions where goods have already been delivered or services rendered, the equity instruments are issued on or about the date the performance is complete (and valued on the date of issuance).
- (b) For transactions where the instruments are issued on a fully vested, non-forfeitable basis, the equity instruments are valued on or about the date of the contract.
- (c) For any transactions not meeting the criteria in (a) or (b) above, the Company re-measures the consideration at each reporting date based on its then current stock value.

IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS

SFAS No. 144, "ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF" addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If the cost basis of a long-lived asset is greater than the projected future undiscounted net cash flows from such asset (excluding interest), an impairment loss is recognized. Impairment losses are calculated as the difference between the cost basis of an asset and its estimated fair value. SFAS No. 144 also requires companies to separately report discontinued operations and extends that reporting requirement to a component of an entity that either has been disposed of (by sale, abandonment or in a distribution to owners) or is classified as held for sale. Assets to be disposed of are reported at the lower of the carrying amount or the estimated fair value less costs to sell. Management believes that no impairment existed at or during the nine months ended December 31, 2006.

7

BENEFICIAL CONVERSION FEATURE OF CONVERTIBLE NOTES PAYABLE

The convertible feature of certain notes payable provides for a rate of conversion that is below market value. Such feature is normally characterized as a "Beneficial Conversion Feature" ("BCF"). Pursuant to EITF Issue No. 98-5, "ACCOUNTING FOR CONVERTIBLE SECURITIES WITH BENEFICIAL CONVERSION FEATURES OR

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

CONTINGENTLY ADJUSTABLE CONVERSION RATIO" and EITF No. 00-27, "APPLICATION OF EITF ISSUE NO. 98-5 TO CERTAIN CONVERTIBLE INSTRUMENTS," the estimated fair value of the BCF is recorded in the consolidated financial statements as a discount from the face amount of the notes. Such discounts are amortized to interest expense over the term of the notes (or conversion of the notes, if sooner).

DERIVATIVE LIABILITIES

The Company evaluates free-standing instruments (or embedded derivatives) indexed to its common stock to properly classify such instruments within equity or as liabilities in its financial statements, pursuant to the requirements of the EITF No. 00-19, "ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS INDEXED TO AND POTENTIALLY SETTLED IN, A COMPANY'S OWN STOCK," EITF No. 01-06, "THE MEANING OF INDEXED TO A COMPANY'S OWN STOCK," EITF No. 05-04, "THE EFFECT OF A LIQUIDATED DAMAGES CLAUSE ON A FREESTANDING FINANCIAL INSTRUMENT SUBJECT TO EITF No. 00-19," and Statement of Financial Accounting Standards ("SFAS") No. 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES," as amended. The Company's policy is to settle instruments indexed to its common shares on a first-in-first-out basis. Based on the Company's evaluation, no derivative liabilities existed at or during the nine months ended December 31, 2006.

CLASSIFICATION OF WARRANT ISSUANCE

In connection with certain convertible notes, the Company has an obligation to issue warrants upon conversion of the notes, which are convertible at any time at the discretion of the noteholders. The obligation to issue the warrants meets the criteria of an embedded derivative to be bifurcated pursuant to SFAS No. 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES" ("SFAS No. 133"), as amended. Under this transaction, the Company is obligated to and has registered for resale the common shares underlying the related warrants. At December 31, 2006, the Company has sufficient registered shares to settle the exercise of the related warrants. As a result, at December 31, 2006, the embedded derivative associated with this warrant obligation meets the scope exception of paragraph 11 (a) of SFAS No. 133. If such were not the case, these warrants would need to be classified as a liability. The classification of these warrants is evaluated at each reporting date.

STOCK BASED COMPENSATION

Effective April 1, 2006, the Company adopted the provisions of SFAS No. 123-R, "SHARE-BASED PAYMENT." SFAS No. 123-R requires employee stock options and rights to purchase shares under stock participation plans to be accounted for under the fair value method and requires the use of an option pricing model for estimating fair value. Accordingly, share-based compensation is measured when all granting activities have been completed, generally the grant date, based on the fair value of the award. Prior to April 1, 2006, the Company accounted for awards granted under its equity incentive plan under the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, "ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES," and related interpretations, and provided the required pro forma disclosures prescribed by SFAS No. 123, "ACCOUNTING FOR STOCK BASED COMPENSATION," as amended. The exercise price of options is generally equal to the market price of the Company's common stock (defined as the closing price as quoted on the Over-the-Counter Bulletin Board administered by Nasdaq) on the date of grant. Under the modified prospective method of adoption for SFAS No. 123-R, the compensation cost recognized by the Company beginning April 1, 2006 includes (a) compensation cost for all equity incentive awards granted prior to, but not yet vested as of April 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all equity incentive awards granted subsequent to April 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123-R.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

From time to time, the Company's Board of Directors grants common share purchase options or warrants to selected directors, officers, employees, consultants and advisors in payment of goods or services provided by such persons on a stand-alone basis outside of any of the Company's formal stock plans. The terms of these grants are individually negotiated and generally expire within five years from the grant date.

8

In August 2000, the Company adopted the 2000 Stock Option Plan ("Stock Option Plan"), which was approved by its stockholders in September 2000. The Stock Option Plan provides for the issuance of up to 500,000 options to purchase shares of common stock. Such options can be incentive options or nonstatutory options, and may be granted to employees, directors and consultants. The Stock Option Plan has limits as to the eligibility of those stockholders who own more than 10% of Company stock, as defined. The options granted pursuant to the Stock Option Plan may have exercise prices of no less than 100% of fair market value of the Company's common stock at the date of grant (incentive options), or no less than 75% of fair market value of such stock at the date of grant (nonstatutory). At December 31, 2006, the Company had granted 47,500 options under the 2000 Stock Option Plan of which 15,000 had been forfeited, with 467,500 available for future issuance. All of these options vested prior to the adoption of FAS 123-R.

The effects of share-based compensation resulting from the application of SFAS No. 123-R to options granted outside of the Company's Stock Option Plan resulted in an expense of \$14,316 for the quarter ended December 31, 2006 and \$23,816 for the nine month period ended December 31, 2006. This expense was recorded as stock compensation included in payroll and related expenses in the accompanying December 31, 2006 condensed consolidated statement of operations. Share-based compensation recognized as a result of the adoption of SFAS No. 123-R as well as pro forma disclosures according to the original provisions of SFAS No. 123 for periods prior to the adoption of SFAS No. 123-R use the Binomial Lattice option pricing model for estimating fair value of options granted.

The following table summarizes the effect of share-based compensation resulting from the application of SFAS No. 123-R to options granted:

	Three Months Ended December 31, 2006	Nine Months Ended December 31, 2006
Payroll and related	\$ 14,316 =====	\$ 23,816 =====
Net share-based compensation effect in net loss from operations	\$ 14,316 =====	\$ 23,816 =====
Basic and diluted loss per common share	\$ (0.00) =====	\$ (0.00) =====

In accordance with SFAS No. 123-R, the Company adjusts share-based compensation on a quarterly basis for changes to the estimate of expected award forfeitures based on actual forfeiture experience. The effect of adjusting the forfeiture rate for all expense amortization after March 31, 2006 is recognized in the period the forfeiture estimate is changed. The effect of forfeiture adjustments for the nine month period ended December 31, 2006 was insignificant.

Pro forma information required under SFAS No. 123 for periods prior to April 1,

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

2006 as if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under and outside of the Company's equity incentive plans was as follows:

	Three Months Ended December 31, 2005 -----	Nine Months Ended December 31, 2005 -----
Net loss as reported	\$ 594,375	\$ 2,069,698
Less: Total stock-based employee compensation expense determined under the Binomial Lattice option pricing model	--	57,000
Pro forma net loss	\$ 594,375 =====	\$ 2,126,698 =====
Basic and diluted loss per common share:		
As reported	\$ (0.03) =====	\$ (0.11) =====
Pro forma	\$ (0.03) =====	\$ (0.11) =====

9

Pro forma compensation expense reported in the above table is generally based on the vesting provisions in the related stock option grants.

Share compensation expense in the three and nine months ended December 31, 2006 relates to the vesting of existing grants (issued subsequent to April 1, 2006), the date the Company adopted SFAS No. 123-R and of grants issued during the current fiscal year.

The following weighted average assumptions were used in the valuation of these instruments.

	2006 -----	2005 -----
Annual dividends	Zero	Zero
Expected volatility	89%	72%
Risk free interest rate	4.82%	4.18%
Expected life	5.0 years	5.0 years

The expected volatility is based on the historic volatility. The expected life of options granted is based on the "simplified method" described in the SEC's Staff Accounting Bulletin No. 107 due to changes in the vesting terms and contractual life of current option grants compared to the Company's historical grants.

Options outstanding that have vested and are expected to vest as of December 31, 2006 are as follows:

	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value (1)
Number of Shares			

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Vested	8,369,060	\$ 0.39	5.58	\$ 178,029
Expected to vest	835,000	0.25	5.92	\$ 13,400
	-----			-----
Total	9,204,060			\$ 191,429
	=====			=====

(1) These amounts represent the difference between the exercise price and \$0.27, the closing market price of the Company's common stock on December 31, 2006 as quoted on the Over-the-Counter Bulletin Board under the symbol "AEMD.OB" for all in-the-money options outstanding.

Options outstanding that are expected to vest are net of estimated future forfeitures in accordance with the provisions of SFAS No. 123-R, which are estimated when compensation costs are recognized. Additional information with respect to stock option activity is as follows:

	Outstanding Options			
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (1)
March 31, 2006	467,500	9,012,785	\$ 0.38	\$3,875,498
Grants	--	500,000	\$ 0.27	
Exercises	--	--	--	
Cancellations	--	(308,725)	\$ 0.38	

December 31, 2006	467,500	9,204,060	\$ 0.38	\$ 191,429
	=====			

Options exercisable at:

March 31, 2006	7,135,518	\$ 0.39
December 31, 2006	8,369,060	\$ 0.39

(1) Represents the difference between the exercise price and the March 31, 2006 or December 31, 2006 market price of the Company's common stock, which was \$0.81 and \$0.27, respectively, for "in the money" options.

INCOME TAXES

Under SFAS No. 109, "ACCOUNTING FOR INCOME TAXES," deferred tax assets and liabilities are recognized for the future tax consequences attributable to the difference between the consolidated financial statements and their respective tax basis. Deferred income taxes reflect the net tax effects of (a) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts reported for income tax purposes, and (b) tax credit carryforwards. The Company records a valuation allowance for deferred tax assets when, based on management's best estimate of taxable income (if any) in the foreseeable future, it is more likely than not that some portion of the deferred tax assets may not be realized.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, "Accounting

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a more-likely-than-not recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken (or expected to be taken) in an income tax return. It also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The requirement to assess the need for a valuation allowance on net deferred tax assets is not affected by FIN No. 48. This pronouncement is effective for fiscal years beginning after December 31, 2006. Management is in the process of evaluating this guidance, and therefore has not yet determined the impact (if any) that FIN No.48 will have on the Company's financial position or results of operation upon adoption.

In September 2006, the FASB issued SFAS No.157, "FAIR VALUE MEASUREMENTS," which defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS No. 157 simplifies and codifies related guidance within GAAP, but does not require any new fair value measurements. The guidance in SFAS No. 157 applies to derivatives and other financial instruments measured at estimated fair value under SFAS No. 133 and related pronouncements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management does not expect the adoption of SFAS No. 157 to have a significant effect on the Company's financial position or results of operation.

NOTE 4. NOTES PAYABLE

At December 31, 2006, the Company had \$502,500 in principal amount of notes payable outstanding with twelve noteholders. The Company is in default on these notes which are unsecured notes payable and is currently seeking other financing arrangements to retire all past due notes. At December 31, 2006 the Company had accrued interest in the amount of \$333,629 associated with these defaulted notes payable.

On December 15, 2006, the Company issued two 10% Convertible Notes ("December 10% Notes") totaling \$50,000 to accredited investors. The December 10% Notes accrue interest at a rate of ten percent (10%) per annum and mature on March 15, 2007. Such notes are convertible into shares of restricted common stock at any time at the election of the holder at a fixed conversion price of \$0.17 per share for any conversion occurring on or before the maturity date. In addition, upon issuance, the Company issued five-year Warrants ("December 10% Note Warrants") to purchase a number of shares equal to the number of shares into which the December 10% Notes can be converted at a fixed exercise price of \$0.17. Additionally, if the December 10% Note Warrants are exercised prior to December 15, 2007, the holder will receive an additional warrant on the same terms as the December 10% Note Warrants on a one to one basis. The warrants can be settled in unregistered shares of common stock. The December 10% Note Warrants have been valued using a Binomial Lattice option pricing model and an associated discount of \$15,627, the relative fair value measured at the commitment date, was recorded and presented net against the face amount of the December 10% Notes. The convertible feature of the December 10% Notes provides for an effective conversion rate that is below market value. Pursuant to EITF No. 98-5 and EITF No. 00-27, the Company estimated the fair value of such BCF to be \$34,373 and recorded such amount as a debt discount. The discounts associated with the warrants and the BCF are being accreted to interest expense over the term of the December 10% Notes. Total interest expense on the December 10% Notes for amortization of such debt discounts totaled approximately \$9,000 for the three month period ended December 31, 2006.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

At December 31, 2006, the Company had \$1,050,000 in principal amount of convertible notes payable outstanding, net of \$770,984 discount, held by six noteholders (four holding 10% Series A Convertible Notes and two holding 10% Convertible Notes). The \$770,984 discount is comprised of \$28,260 in unamortized BCF discount and \$742,724 in unamortized discount attributable to the valuation of warrant rights associated with the issuance of the convertible notes. The common shares underlying these warrants were registered by the Company in January 2006.

NOTE 5. EQUITY TRANSACTIONS

In April 2006, the Company issued 3,782 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.79 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

11

In April 2006, the Company issued 25,601 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.50 per share in payment for past due rents owed by the Company valued at \$12,801 based on the value of the services.

In April 2006, the Company issued 6,313 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.79 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In April 2006, the Company issued 10,000 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.50 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In April 2006, the Company issued 14,563 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.29 per share in payment for regulatory affairs consulting services to the Company valued at \$4,165 based on the value of the services.

In April 2006, the Company issued 3,086 shares of restricted common stock at \$0.81 per share in payment for investor relations valued at \$2,500 based on the value of the services.

During April 2006, the Company issued 209,679 shares of common stock at prices between \$0.57 and \$0.74 per share to Fusion Capital under its \$6,000,000 common stock purchase agreement for net cash proceeds totaling \$140,002. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004.

In April 2006, the Company repaid a \$25,000 15% promissory notes, including accrued interest of \$18,750, through the issuance of 107,759 restricted common shares at \$0.406 per share to an accredited individual investor. There was no gain or loss on the extinguishment.

In May 2006, the Company issued 8,532 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.59 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In May 2006, the Company issued 5,703 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Stock Plan at \$0.53 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In May 2006, the Company issued 4,545 shares of restricted common stock at \$0.55 per share in payment for investor relations valued at \$2,500 based on the value of the services.

In June 2006, the Company issued 8,681 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.58 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In June 2006, the Company issued 5,703 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.53 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In June 2006, the Company issued 3,363 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.45 per share in payment for regulatory affairs consulting services to the Company valued at \$1,500 based on the value of the services.

In July 2006, the Company issued 8,721 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.34 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In July 2006, the Company issued 10,684 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.47 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In July 2006, the Company issued 6,250 shares of restricted common stock at \$0.40 per share in payment for investor relations services to the Company valued at \$2,500 based on the value of the services.

In July 2006, the Company issued 7,813 shares of restricted common stock at \$0.32 per share in payment for investor relations services to the Company valued at \$2,500 based on the value of the services.

12

In July 2006, the Company issued 8,721 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.34 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In July 2006, the Company issued 132,765 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.37 per share in payment for regulatory affairs consulting services to the Company valued at \$48,858 based on the value of the services.

In July 2006, the Company issued 14,535 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.34 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

During August 2006, the Company issued 113,235 shares of common stock at prices between \$0.26 and \$0.27 per share to Fusion Capital under its \$6,000,000 common stock purchase agreement for net cash proceeds totaling \$30,000. These shares

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004.

In August 2006, the Company issued 9,434 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.32 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In August 2006, the Company issued 86,779 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.25 per share in payment for general legal expenses to the Company valued at \$22,085 based on the value of the services.

In August 2006, the Company issued 114,132 shares of restricted common stock at \$0.20 per share in payment for accrued accounting consulting services provided to the Company by a third party valued at \$23,111 based upon the value of the services.

During September 2006, the Company issued 439,936 shares of common stock at prices between \$0.25 and \$0.26 per share to Fusion Capital under its \$6,000,000 common stock purchase agreement for net cash proceeds totaling \$110,000. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004.

In September 2006, the Company issued 4,808 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.31 per share in payment for regulatory affairs consulting services to the Company valued at \$1,500 based on the value of the services.

In September 2006, the Company issued 15,723 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.32 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In September 2006, the Company issued 9,868 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.30 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In September 2006, the Company issued 16,447 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.30 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In September 2006, the Company issued 9,733 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.26 per share in payment for regulatory affairs consulting services to the Company valued at \$2,550 based on the value of the services.

During October 2006, the Company issued 201,165 shares of common stock at \$0.25 per share to Fusion Capital under its \$6,000,000 common stock purchase agreement for net cash proceeds totaling \$50,000. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004.

In October 2006, the Company issued 8,065 shares of restricted common stock at \$0.31 per share in payment for investor relations services to the Company valued at \$2,500 based on the value of the services.

In October 2006, the Company issued 8,929 shares of restricted common stock at \$0.28 per share in payment for investor relations services to the Company valued at \$2,500 based on the value of the services.

In October 2006, the Company issued 18,797 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.27 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In October 2006, the Company issued 11,278 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.27 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In October 2006, the Company issued 7,540 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.25 per share in payment for regulatory affairs consulting services to the Company valued at \$1,900 based on the value of the services.

In November 2006, the Company issued 555,556 shares of restricted common stock at \$0.18 per share in exchange for an investment of \$100,000. As an inducement the Company also issued five-year warrants to purchase a number of shares equal to the number of restricted shares issued converted at a fixed exercise price of \$0.18. Additionally, if the warrants are exercised prior to November 14, 2007, the holder will receive an additional warrant on the same terms as the warrants.

In November 2006, the Company issued 11,905 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.25 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In November 2006, the Company issued 19,841 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.25 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In December 2006, the Company issued 12,397 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.24 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In December 2006, the Company issued 20,661 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.24 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

In December 2006, the Company issued 40,000 shares of restricted common stock at \$0.25 per share in exchange for license and development rights related to certain intellectual property valued at \$10,000 based on the fair market value of the the intellectual property license.

During December 2006, the Company issued 118,360 shares of common stock at prices between \$0.25 and \$0.26 per share to Fusion Capital under its \$6,000,000 common stock purchase agreement for net cash proceeds totaling \$30,000. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004.

NOTE 6. SUBSEQUENT EVENTS

In January 2007, the Company issued 15,248 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at \$0.28 per share in payment for regulatory affairs consulting

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

services to the Company valued at \$4,300 based on the value of the services.

In January 2007, the Company issued 10,714 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at \$0.28 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services.

In January 2007, the Company issued 125,091 shares of restricted common stock at between \$0.24 and \$0.31 per share in payment for investor relations services to the Company valued at \$32,500 based on the value of the services.

In January 2007, the Company issued 17,857 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at \$0.28 per share in payment for regulatory affairs consulting services to the Company valued at \$5,000 based on the value of the services.

During January 2007, the Company issued 471,936 shares of common stock at prices between \$0.25 and \$0.26 per share to Fusion Capital under its \$6,000,000 common stock purchase agreement for net cash proceeds totaling \$120,000. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004.

During February 2007, the Company issued 110,974 shares of common stock at prices between \$0.263 and \$0.28 per share to Fusion Capital under its \$6,000,000 common stock purchase agreement for net cash proceeds totaling \$30,000. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004.

14

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion of Aethlon Medical's financial condition and results of operations should be read in conjunction with, and is qualified in its entirety by the condensed consolidated (unaudited) financial statements and notes thereto, included in Item 1 in this Quarterly Report on Form 10-QSB. This item contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those indicated in such forward-looking statements.

FORWARD LOOKING STATEMENTS

All statements, other than statements of historical fact, included in this Form 10-QSB are, or may be deemed to be, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended ("the Securities Act"), and Section 21E of the Exchange Act. Such forward-looking statements involve assumptions, known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of Aethlon Medical, Inc. ("the Company") to be materially different from any future results, performance, or achievements expressed or implied by such forward looking statements contained in this Form 10-QSB. Such potential risks and uncertainties include, without limitation, completion of the Company's capital-raising activities, FDA approval of the Company's products, other regulations, patent protection of the Company's proprietary technology, product liability exposure, uncertainty of market acceptance, competition, technological change, and other risk factors detailed herein and in other of the Company's filings with the Securities and Exchange Commission. The forward-looking statements are made as of the date of this Form 10-QSB, and the Company assumes no obligation to update the forward-looking statements, or to update the reasons actual results could differ from those projected in such forward-looking

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

statements.

THE COMPANY

We are a developmental stage medical device company focused on expanding the applications of our Hemopurifier(R) platform technology which is designed to rapidly reduce the presence of infectious viruses and other toxins from human blood. As such, we focus on developing therapeutic devices to treat acute viral conditions brought on by pathogens targeted as potential biological warfare agents and chronic viral conditions including HIV/AIDS and Hepatitis-C. The Hemopurifier(R) combines the established scientific technologies of hemodialysis and affinity chromatography as a means to mimic the immune system's response of clearing viruses and toxins from the blood before cell and organ infection can occur. The Hemopurifier(R) cannot cure these afflictions but can lower viral loads and allow compromised immune systems to overcome otherwise serious or fatal medical conditions.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the informational requirements of the Securities Exchange Act and must file reports, proxy statements and other information with the SEC. The reports, information statements and other information we file with the Commission can be inspected and copied at the Commission Public Reference Room, 450 Fifth Street, N.W. Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (800) SEC-0330. The Commission also maintains a Web site (<http://www.sec.gov>) that contains reports, proxy, and information statements and other information regarding registrants, like us, which file electronically with the Commission. the Company's headquarters are located at 3030 Bunker Hill Street, Suite 4000, San Diego, CA 92109. Our phone number at that address is (858) 459-7800. Its Web site is maintained at <http://www.aethlonmedical.com>.

RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2006 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2005

Operating Expenses

Consolidated operating expenses for the three months ended December 31, 2006 were \$464,994 in comparison with \$494,014 for the comparable quarter a year ago. The reduction of \$29,020, or 5.9% was comprised of an increase in Payroll & Related expenses of \$55,584 and an increase in general and administrative expenses of \$3,102 offset by a decrease in professional fees of \$87,706

15

Payroll & Related expenses increased by \$55,584 or approximately 34% from the prior period one year ago. The primary reasons for this include the hiring of a new President in July 2006 combined with increases in the salaries of our Chief Executive and Chief Scientific Officers. General & Administrative expenses increased by \$3,102 or approximately 3% due to small decreases in all general expenses offset by a \$6,443 increase in employee health insurance premiums. Professional fees decreased \$87,706 or approximately 40%, as compared to the prior quarter one year ago a result of a \$39,404 reduction in scientific consulting fees, a \$75,423 decrease in legal expense, a \$22,689 reduction in other professional expenses offset by an increase of \$49,812 related to investor

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

relations.

Interest Expense

Interest expense decreased \$24,596 or approximately 25% a result of a reduction in the amortization of BCF related to convertible notes in the current quarter as compared to the same quarter one year ago.

Net Loss

The Company recorded a consolidated net loss of \$540,759 and \$594,375 for the three months ended December 31, 2006 and 2005, respectively. The decreased net loss was primarily attributable to a \$29,020 decrease in operating expense combined with a \$24,595 decrease in interest expense as noted immediately above.

Basic and diluted loss per common share was (\$0.02) for the three month period ended December 31, 2006 compared to (\$0.03) for the same period ended December 31, 2005. This reduction in loss per share was a result of the greater number of common shares outstanding during the three month period ended December 31, 2006, as compared to the three month period ended December 31, 2005, combined with the decreased net loss for the three month period ended December 31, 2006, as compared to the three month period ended December 31, 2005.

NINE MONTHS ENDED DECEMBER 31, 2006 COMPARED TO THE NINE MONTHS ENDED DECEMBER 31, 2005

Operating Expenses

Consolidated operating expenses were \$1,504,427 for the nine months ended December 31, 2006, versus \$1,783,469 for the comparable period ended December 31, 2005. The reduction of \$279,042, or approximately 16%, is a result of reductions in professional fees and general & administrative expenses of \$376,074 and \$2,608, respectively, offset by a \$99,640 increase in payroll and related expenses.

For the comparable nine-month periods, professional fees decreased \$376,074 or approximately 43%, while general and administrative expenses decreased \$2,608 or approximately 1%. These decreases were offset by an increase in payroll and related expenses of \$99,640 or approximately 19%.

The professional fee expense decrease is comprised of a reduction in legal fees of \$288,556, a reduction in scientific consulting expense of \$124,846 and an increase in all other professional expenses of \$37,330. Legal fee expense was higher in the prior period due to the issuance of warrants in settlement of a legal fee obligation. There was no similar issuance in the current fiscal year. Scientific consulting expense decreased because in the prior period the Company was conducting its Human Safety Trials in India and had no comparable study in progress for the current nine-month period.

The general and administrative expense decrease is comprised of a \$72,844 reduction in laboratory supplies offset by increases in investor conference expenses of \$36,958, insurance expense of \$11,551 and other expense decreases of \$4,758. The reduced laboratory supplies expense is explained by the higher expenses recognized during the prior nine-month period one year ago during the company's Human Safety Trial in India. Investor conference expense increased due to our increased participation in various investor related conferences and programs.

Payroll and related expense increases are a result of having a full-time Chief Financial Officer for the full nine-month period, of the addition of a new

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

President in July 2006 and of salary increases given to our Chief Executive and Chief Scientific Officers beginning in the first quarter of fiscal 2007.

Interest Expense

Interest expense remained essentially unchanged in comparison with the comparable nine-month period one year ago.

16

Net Loss

We recorded a consolidated net loss of \$1,787,569 and \$2,069,698 for the nine-month periods ended December 31, 2006 and 2005, respectively. The decrease in net loss was primarily attributable to a net decrease in operating expenses. Basic and diluted loss per common share were (\$0.07) for the nine-month period ended December 31, 2006 compared to (\$0.11) for the same period ended December 31, 2005. This reduction in loss per share was attributable to both the greater number of common shares outstanding during the nine-month period ended December 31, 2006, as compared to the nine-month period ended December 31, 2005, and by the decreased net loss for the nine-month period ended December 31, 2006, as compared to the equivalent period one year ago.

LIQUIDITY AND CAPITAL RESOURCES

To date, the Company has funded its capital requirements for the current operations from net funds received from the public and private sale of debt and equity securities, as well as from the issuance of common stock in exchange for services. The Company's cash position at December 31, 2006 was \$44,315 compared to \$836,377, at March 31, 2006, representing a decrease of \$792,062. During the nine-months ended December 31, 2006, operating activities used net cash of \$1,284,359 while the Company received \$460,003 from the issuance of common stock and \$50,000 from the issuance of convertible notes, purchased \$14,454 of new equipment and spent \$3,252 on patents pending.

During the nine-month period ended December 31, 2006, net cash used in operating activities primarily consisted of net loss of \$1,787,569. Net loss was offset principally by depreciation and amortization of \$21,256 plus the fair market value of common stock of \$195,358 in payment for services, \$136,651 of amortization of debt discount, \$23,816 in stock-based compensation and a net increase in accounts payable and other current balance sheet accounts of \$89,379.

A decrease in working capital during the nine months ended December 31, 2006 in the amount of \$947,231 increased the Company's negative working capital position to (\$2,867,894) at December 31, 2006 as compared to a negative working capital of (\$1,920,663) at March 31, 2006.

The Company's current deficit in working capital required us to obtain funds in the short-term to be able to continue in business, and in the longer term to fund research and development on products not yet ready for market. The Company's operations to date have consumed substantial capital without generating revenues, and will continue to require substantial and increasing capital funds to conduct necessary research and development and pre-clinical and clinical testing of Hemopurifier(R) products, and to market any of those products that receive regulatory approval. The Company does not expect to generate revenue from operations for the foreseeable future, and its ability to meet its cash obligations as they become due and payable is expected to depend for at least the next several years on its ability to sell securities, borrow

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

funds or a combination thereof. The Company's future capital requirements will depend upon many factors, including progress with pre-clinical testing and clinical trials, the number and breadth of our programs, the time and costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other proprietary rights, the time and costs involved in obtaining regulatory approvals, competing technological and market developments, and management's ability to establish collaborative arrangements, effect successful commercialization strategies, marketing activities and other arrangements. The Company expects to continue to incur increasing negative cash flows and net losses for the foreseeable future, and presently requires a minimum of \$150,000 per month to sustain operations.

Management does not believe that inflation has had or is likely to have any material impact on the Company's limited operations.

At the date of this filing, we do not have plans to purchase significant amounts of equipment or hire significant numbers of employees prior to successfully raising additional capital.

17

PLAN OF OPERATION

The Company's current plan of operation is to fund our anticipated increased research and development activities and operations through the common stock purchase agreement in place with Fusion Capital, whereby Fusion Capital has committed to buy up to an additional \$6,000,000 of our common stock over a 30-month period, that commenced, at our election, after the SEC declared effective a registration statement under Form SB-2 on December 7, 2004 covering such shares. Through December 31, 2006 the Company had received \$1,905,001 and has \$4,094,999 remaining available from this agreement. However, no assurance can be given that we will receive any additional funds under our agreement with Fusion Capital. Based on our projections of additional employees and equipment for operations and to complete research, development and testing associated with

our Hemopurifier(R) products, we anticipate that these funds will satisfy our cash requirements, including this anticipated increase in operations, in excess of the next twelve months. However, due to market conditions, and to assure availability of funding for operations in the long term, we may arrange for additional funding, subject to acceptable terms, during the next twelve months.

The Company is a development stage medical device company that has not yet engaged in significant commercial activities. The primary focus of our resources is the advancement of our proprietary Hemopurifier(R) platform treatment technology, which is designed to rapidly reduce the presence of infectious viruses and toxins in human blood. Our main focus is to prepare our Hemopurifier(R) to treat HIV/AIDS, Hepatitis-C and Flu Viruses in human clinical trials. The Company is also working to advance pathogen filtration devices to treat infectious agents that may be used in biological warfare and terrorism.

The Company plans to continue our research and development activities related to our Hemopurifier(R) platform technology, with particular emphasis on the advancement of our lead product candidates for the treatment of potential bioterror agents. The Company is in the process of implementing a regulatory strategy for the use of our Hemopurifier(R) for biodefense treatments pursuant to a recent rule implemented by the FDA for medical countermeasures to weapons of mass destruction. Under this rule, in situations where it is deemed unethical to conduct efficacy studies in humans, a treatment can be reviewed for approval on the basis of efficacy in the most relevant animal species and safety data in

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

humans.

The Company expects to outsource research and development in the next twelve months, as required to support our increased research and development effort that will include expanding our goal beyond treating infectious diseases HIV/AIDS and Hepatitis-C and new applications to combat infectious agents that may be used in biological warfare and terrorism. This will involve designing Hemopurifier(R) products that can be rapidly deployed by armed forces as wearable post-exposure treatments on the battlefield, as well as dialysis-based treatments for civilian populations. This will entail developing the new treatment device based on the same proprietary Hemopurifier(R) filtration technology that is utilized in advancing our HIV/AIDS, and Hepatitis-C treatments.

Accordingly, due to this increase in activity during the next twelve months, management anticipates continuing to increase spending on outsourced research and development during this period.

Operations to date have consumed substantial capital without generating revenues, and will continue to require substantial and increasing capital funds to conduct necessary research and development and pre-clinical and clinical testing of our Hemopurifier(R) products, as well as market any of those products that receive regulatory approval. The Company does not expect to generate revenue from operations for the foreseeable future, and our ability to meet our cash obligations as they become due and payable is expected to depend for at least the next several years on our ability to sell securities, borrow funds or a combination thereof. Future capital requirements will depend upon many factors, including progress with pre-clinical testing and clinical trials, the number and breadth of our clinical programs, the time and costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other proprietary rights, the time and costs involved in obtaining regulatory approvals, competing technological and market developments, as well as management's ability to establish collaborative arrangements, effective commercialization, marketing activities and other arrangements. The Company expects to continue to incur increasing negative cash flows and net losses for the foreseeable future.

18

CRITICAL ACCOUNTING POLICIES

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make a number of 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. Such estimates and assumptions affect the reported amounts of expenses during the reporting period. On an ongoing basis, the Company evaluates estimates and assumptions based upon historical experience and various other factors and circumstances. Management believes the Company's estimates and assumptions are reasonable in the circumstances; however, actual results may differ from these estimates under different future conditions.

The Company believes that the estimates and assumptions that are most important to the portrayal of the Company's financial condition and results of operations, in that they require the most difficult, subjective or complex judgments, form the basis for the accounting policies deemed to be most critical to us. These critical accounting policies include our estimates associated with stock purchase warrants issued with notes payable, beneficial conversion feature of convertible notes payable, impairment of our intangible assets and long lived

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

assets, stock compensation, contingencies and litigation. We believe estimates and assumptions related to these critical accounting policies are appropriate under the circumstances; however, should future events or occurrences result in unanticipated consequences, there could be a material impact on the Company's future financial conditions or results of operations.

There have been no changes to the Company's critical accounting policies as disclosed in its Form 10-KSB for the year ended March 31, 2006.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources and would be considered material to investors.

ITEM 3. CONTROLS AND PROCEDURES

Under the supervision and with the participation of Management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this report (the "Evaluation Date"). Based upon that evaluation, the CEO and CFO concluded that, as of December 31, 2006, our disclosure controls and procedures were effective in timely alerting them to the material information relating to us (or our consolidated subsidiaries) required to be included in our periodic filings with the SEC.

Changes in Controls and Procedures

There were no significant changes made in our internal controls over financial reporting during the quarter ended December 31, 2006 that have materially affected or are reasonably likely to materially affect these controls. Thus, no corrective actions with regard to significant deficiencies or material weaknesses were necessary. On August 1, 2005 the Company hired a new full-time Chief Financial Officer.

Limitations on the Effectiveness of Internal Control

Management, including the CEO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material errors. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control 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 on all internal control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Aethlon Medical have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, and/or by management override of the control. The design of any system of internal control is also based in part upon 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. Over time, controls may become inadequate because of changes in circumstances, and/or the degree of compliance with the

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective internal control system, financial reporting misstatements due to error or fraud may occur and not be detected on a timely basis.

19

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

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

In October 2006, the Company issued 8,065 shares of restricted common stock at \$0.31 per share in payment for investor relations services. The shares were issued without registration under the Securities Act in reliance upon the exemption from registration set forth in Section 4(2).

In October 2006, the Company issued 8,929 shares of restricted common stock at \$0.28 per share in payment for investor relations services. The shares were issued without registration under the Securities Act in reliance upon the exemption from registration set forth in Section 4(2).

In November 2006, the Company issued 555,556 shares of restricted common stock at \$0.18 per share in exchange for an investment of \$100,000. As an inducement the Company also issued five-year warrants to purchase a number of shares equal to the number of restricted shares issued converted at a fixed exercise price of \$0.18. Additionally, if the warrants are exercised prior to November 14, 2007, the holder will receive an additional warrant on the same terms as the warrants. The shares and warrants were issued without registration under the Securities Act in reliance upon the exemption from registration set forth in Section 4(2).

In December 2006, the Company issued 40,000 shares of restricted common stock At \$0.25 per share in exchange for license and development rights related to certain intellectual property valued at \$10,000. The shares were issued without registration under the Securities Act in reliance upon the exemption from registration set forth in Section 4(2).

In January 2007, the Company issued 125,091 shares of restricted common stock at between \$0.24 and \$0.31 per share in payment for investor relations services to the Company valued at \$32,500. The shares were issued without registration under the Securities Act in reliance upon the exemption from registration set forth in Section 4(2).

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

As of the date of this report, various promissory and convertible notes payable in the aggregate principal amount of \$502,500 have reached maturity and are past due. The Company is continually reviewing other financing arrangements to retire all past due notes. At December 31, 2006 the Company had accrued interest in the amount of \$333,629 associated with these notes and accrued liabilities payable.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

20

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

(a) Exhibits. The following documents are filed as part of this report:

- 31.1 Certification of CEO pursuant to Securities Exchange Act rules 13a-15 and 15d-15(c) as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of CFO pursuant to Securities Exchange Act rules 13a-15 and 15d-15(c) as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of James A. Joyce, Chief Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of James W. Dorst, Chief Financial Officer (Principal Accounting Officer) pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

21

SIGNATURES

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

AETHLON MEDICAL, INC

Date: February 13, 2007

BY: /S/ JAMES A. JOYCE

BY: /S/ JAMES W. DORST

JAMES A. JOYCE
CHAIRMAN, PRESIDENT AND
CHIEF EXECUTIVE OFFICER

JAMES W. DORST
CHIEF FINANCIAL OFFICER