

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

AETHLON MEDICAL INC
Form 10QSB
February 19, 2008

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, 2007

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 37,169,186 as of January 22, 2008.

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

Transitional Small Business Disclosure Format (check one): Yes No

PART I. FINANCIAL INFORMATION

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

ITEM 1.	CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)	
	CONDENSED CONSOLIDATED BALANCE SHEET AT DECEMBER 31, 2007 (UNAUDITED)	3
	CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED DECEMBER 31, 2007 AND 2006 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2007 (UNAUDITED)	4
	CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED DECEMBER 31, 2007 AND 2006 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2007 (UNAUDITED)	5
	NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS	6
ITEM 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION	17
ITEM 3.	CONTROLS AND PROCEDURES	21
PART II. OTHER INFORMATION		
ITEM 1.	LEGAL PROCEEDINGS	22
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	22
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	23
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	23
ITEM 5.	OTHER INFORMATION	23
ITEM 6.	EXHIBITS	24

PART I.

FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	December 31, 2007 -----
	ASSETS
Current assets	
Cash	\$ 333,271
Deferred financing costs	55,000
Prepaid expenses and other current assets	5,000

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Total current assets	393,271
Property and equipment, net	10,425
Patents and patents pending, net	139,453
Other assets	13,200
Total assets	\$ 556,349

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current Liabilities	
Accounts payable and accrued liabilities	\$ 935,543
Due to related parties	1,083,999
Notes payable	502,500
Convertible notes payable, net of discount	815,711
Warrant obligation	731,274
Total current liabilities	4,069,027
Commitments and Contingencies	
Stockholders' Deficit	
Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 36,428,399 shares issued and outstanding	36,429
Additional paid-in capital	27,932,219
Deficit accumulated during development stage	(31,481,326)
	(3,512,678)
Total liabilities and stockholders' deficit	\$ 556,349

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

AETHLON MEDICAL, INC.
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF
OPERATIONS For the Three and Nine Months Ended
December 31, 2007 and 2006 and
For the Period January 31, 1984 (Inception) Through December 31, 2007
(Unaudited)

Three Months Ended December 31, 2007	Three Months Ended December 31, 2006	Nine Months Ended December 31, 2007	Nine Months Ended December 31, 2006
---	---	--	--

REVENUES

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Grant income	\$	--	\$	--	\$	--	\$	--
Subcontract income		--		--		--		--
Sale of research and development		--		--		--		--
		-----		-----		-----		-----
		--		--		--		--
EXPENSES								
Professional Fees		132,419		133,316		573,495		499,964
Payroll and related		285,373		220,539		1,107,149		611,816
General and administrative		109,183		111,139		407,632		392,647
Impairment		--		--		--		--
		-----		-----		-----		-----
		526,975		464,994		2,088,276		1,504,427
		-----		-----		-----		-----
OPERATING LOSS		(526,975)		(464,994)		(2,088,276)		(1,504,427)
		-----		-----		-----		-----
OTHER EXPENSE (INCOME)								
Loss on extinguishment of debt		489,013		--		489,013		--
Change in fair value of warrant liability		633,249		--		(280,776)		--
Interest and other debt expenses		952,068		75,765		1,077,794		283,142
Interest income		--		--		--		--
Other		1,778		--		20,027		--
		-----		-----		-----		-----
		2,076,108		75,765		1,306,058		283,142
		-----		-----		-----		-----
NET LOSS	\$	(2,603,083)	\$	(540,759)	\$	(3,394,334)	\$	(1,787,569)
		=====		=====		=====		=====
BASIC AND DILUTED LOSS PER COMMON SHARE								
	\$	(0.07)	\$	(0.02)	\$	(0.10)	\$	(0.07)
		=====		=====		=====		=====
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING								
		35,077,841		27,174,574		33,352,579		27,174,574
		=====		=====		=====		=====

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

4

AETHLON MEDICAL, INC.
(A DEVELOPMENT STAGE COMPANY)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED DECEMBER 31, 2007 AND 2006 AND
FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2007
(Unaudited)

Nine Months Ended December 31, 2007 (Unaudited)	Nine Months Ended December 31, 2006 (Unaudited)	Janua (In T Dec
-----	-----	-----

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Cash flows from operating activities:

Net loss	\$ (3,394,334)	\$ (1,787,569)	\$ (3)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	16,616	21,256	
Amortization of deferred consulting fees	--	36,750	
Gain on sale of property and equipment	--	--	
Gain on settlement of debt	--	--	
Loss on settlement of accrued legal liabilities	--	--	
Stock based compensation	422,397	23,816	
Loss on debt extinguishment	489,013	--	
Fair market value of warrants issued in connection with accounts payable and debt	--	--	
Fair market value of common stock, warrants and options issued for services	197,107	195,358	
Change in fair value of warrant liability	(280,776)	--	
Debt issuance costs	(55,000)	--	
Amortization of debt discount	415,575	136,651	
Impairment of patents and patents pending	--	--	
Impairment of goodwill	--	--	
Deferred compensation forgiven	--	--	
Changes in operating assets and liabilities:			
Prepaid expenses	(430)	14,791	
Other assets	--	4,000	
Accounts payable and accrued liabilities	(438,534)	178,588	
Due to related parties	(5,000)	(108,000)	
Net cash used in operating activities	(1,518,773)	(1,284,359)	(1)

Cash flows from investing activities:

Purchases of property and equipment	(4,215)	(14,454)	
Patents and patents pending	(6,797)	(3,252)	
Proceeds from the sale of property and equipment	--	--	
Cash of acquired company	--	--	
Net cash used in investing activities	(11,012)	(17,706)	(1)

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	500,000	50,000	
Proceeds from the issuance of common stock	922,950	460,003	
Professional fees related to registration statement	--	--	
Net cash provided by financing activities	1,422,950	510,003	1

Net (decrease) increase in cash	(106,835)	(792,062)	
Cash at beginning of period	440,106	836,377	
Cash at end of period	\$ 333,271	\$ 44,315	\$

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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

5

AETHLON MEDICAL, INC.
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
December 31, 2007

NOTE 1. NATURE OF BUSINESS AND BASIS OF PRESENTATION

Aethlon Medical, Inc. (the "Company") is a development 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. In this regard, our core focus is the development of therapeutic devices that treat acute viral conditions, chronic viral diseases and pathogens targeted as potential biological warfare agents. The Hemopurifier(R) combines the established scientific principles of affinity chromatography and hemodialysis 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 viral conditions but can prevent virus and toxins from infecting unaffected tissues and cells. We have completed pre-clinical blood testing of the Hemopurifier(R) to treat HIV and Hepatitis-C, and have completed human safety trials on Hepatitis-C infected patients in India and are in the process of obtaining regulatory approval from the U.S. Food and Drug Administration ("FDA") to initiate clinical trials in the United States.

The commercialization of the Hemopurifier(R) will likely require the completion of human efficacy clinical trials. The approval of any application of the Hemopurifier(R) in the United States will necessitate the approval of the FDA to initiate human studies. Such studies could take years to demonstrate safety and effectiveness in humans and there is no assurance that the Hemopurifier(R) will be cleared by the FDA as a device we can market to the medical community. We also expect to face similar regulatory challenges from foreign regulatory agencies, should we attempt to commercialize and market the Hemopurifier(R) outside of the United States. As a result, we have not generated revenues from the sale of any Hemopurifier(R) application. Additionally, there have been no independent validation studies of our Hemopurifiers(R) to treat infectious disease. We manufacture our products on a small scale for testing purposes but have yet to manufacture our products on a large scale for commercial purposes. All of our pre-clinical human blood studies have been conducted in our laboratories under the direction of Dr. Richard Tullis, our Chief Science Officer.

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)

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended December 31, 2007 are not necessarily indicative of the results that may be expected for the year ending March 31, 2008. For further information, refer to the Company's Annual Report On Form 10-KSB for the year ended March 31, 2007, which includes audited financial statements and footnotes as of March 31, 2007 and for the years ended March 31, 2006 and 2007.

6

NOTE 2. GOING CONCERN AND LIQUIDITY CONSIDERATIONS

The accompanying unaudited condensed consolidated financial statements have been prepared on a going concern basis, which contemplates, among other things, the realization of assets and the satisfaction of liabilities in the ordinary course of business. The Company has experienced continuing losses from operations, is in default on certain debt, has negative working capital of approximately (\$3,676,000) recurring losses from operations and a deficit accumulated during the development stage of approximately (\$31,481,000) at December 31, 2007, which among other matters, raises significant doubt about its ability to continue as a going concern. The Company has not generated significant revenue or any profit from operations since inception. A significant 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 intends to fund operations through debt and/or equity financing arrangements, which management believes may be insufficient to fund its capital expenditures, working capital and other cash requirements (consisting of accounts payable, accrued liabilities, amounts due to related parties and amounts due under various notes payable) for the fiscal year ending March 31, 2008. Therefore the Company will be required to seek additional funds to finance its short-term operations.

The Company is currently addressing its liquidity issue by exploring investment capital opportunities through the public markets, specifically, through private placement of common stock. The Company believes that its access to capital, together with existing cash resources, will be sufficient to meet its liquidity needs for fiscal 2008. However, no assurance can be given that the Company will receive any funds in addition to the funds in its capital raising efforts.

The unaudited 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.

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.

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 exist no material intercompany transactions or balances.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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 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 17,531,110 and 14,209,120 potentially dilutive common shares outstanding for the three and nine months ended December 31, 2007, 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, upon issuance of the patent.

7

RESEARCH AND DEVELOPMENT EXPENSES

The Company incurred approximately \$466,000 and \$440,000 of research and development expenses during the nine months ended December 31, 2007 and 2006, respectively. For the fiscal quarter ended December 31, 2007 and 2006, the Company incurred research and development expense of approximately \$135,000 and \$105,000, respectively.

EQUITY INSTRUMENTS FOR SERVICES PROVIDED BY OTHER THAN EMPLOYEES

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 ("SFAS 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 144 requires

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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 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, 2007.

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 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, when applicable, 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.

8

DERIVATIVE LIABILITIES AND CLASSIFICATION

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 Issue No. 00-19, "ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS INDEXED TO AND POTENTIALLY SETTLED IN, A COMPANY'S OWN STOCK," EITF Issue No. 01-06, "THE MEANING OF INDEXED TO A COMPANY'S OWN STOCK," FSP EITF Issue No. 00-19-2, "ACCOUNTING FOR REGISTRATION PAYMENT ARRANGEMENTS," and 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. Pursuant to EITF Issue No. 00-19, the classification of an instrument indexed to the company's stock must be reassessed at each balance sheet date. If the classification required under this Consensus changes as a result of events during a reporting period, the instrument should be reclassified as of the date of the event that caused the reclassification. There is no limit on the number of times a contract may be reclassified.

In the fiscal year ending March 31, 2006, the Company was obligated to register for resale the shares underlying warrants in connection with the issuance of its 10% Series A Convertible Notes. In accordance with EITF Issue No. 00-19, the value of the warrants was recorded as a liability until the registration became effective on January 20, 2006. On or about March 13, 2007, the Company determined that the effectiveness of the registration statement underlying the conversion and warrant shares associated with the 10% Series A Convertible Notes had lapsed. In accordance with EITF Issue No. 00-19, the Company reclassified the warrants from stockholders' equity and recorded a warrant liability which is required to be revalued at the end of each reporting period. Such warrant liability was revalued through September 30, 2007 (our latest reporting period) and then on November 29, 2007. On November 29, 2007, the notes and warrant agreements associated with the 10% Series A Convertible Notes were amended and restated. For accounting purposes, such amendment was treated as an extinguishment pursuant to EITF Issue No. 06-6 and the existing warrant

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

liability relieved. See Note 4 for further description.

REGISTRATION PAYMENT ARRANGEMENTS

The Company accounts for its liquidated damages on registration rights agreements in accordance with FASB Staff Position EITF Issue No. 00-19-2 "ACCOUNTING FOR REGISTRATION PAYMENT ARRANGEMENTS" which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with SFAS No. 5, "ACCOUNTING FOR CONTINGENCIES" ("SFAS No. 5"). Pursuant to SFAS No. 5, a liability related to potential liquidated damages if such damages were determined to be both probable and reasonably estimable. The Company had accrued liquidated damages on the 10% Series A Convertible Notes. In connection with the amendment of these instruments and related warrants on November 29, 2007, the liquidated damages related to these Notes were settled. As of December 31, 2007, the Company has accrued \$26,000 in liquidated damages in connection with potential liquidated damages related to the November 29, 2007 transaction. See Note 4 for further description.

STOCK BASED COMPENSATION

Effective April 1, 2006, the Company adopted the provisions of SFAS No. 123-R, "Share-Based Payment," ("SFAS No. 123-R"). 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 at the grant date, based on the fair value of the award. The Company previously accounted for awards granted under its equity incentive plan under the intrinsic value method prescribed by Accounting Principles Board 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. Accordingly, no share-based compensation was recognized in the financial statements for periods prior to April 1, 2006.

9

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.

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. Such grants are recorded based on the grant date fair value of the equity instruments.

In August 2000, the Company adopted the 2000 Stock Option Plan ("Stock Option Plan"), which was approved by its stockholders in December 2000. The Stock Option Plan provides for the issuance of up to 500,000 options to purchase

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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, 2007, the Company had granted 47,500 options under the 2000 Stock Option Plan of which 15,000 had been forfeited. All of these options vested prior to the adoption of SFAS 123-R. The Company has reserved 467,500 shares for future issuance.

Share-based compensation resulting from the application of SFAS No. 123-R to options granted resulted in an expense of \$69,446 for the quarter ended December 31, 2007 and \$422,397 for the nine month period ended December 31, 2007. The Company uses 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, 2007	Nine Months Ended December 31, 2007
Payroll and related	\$ 69,446 =====	\$ 422,397 =====
Net share-based compensation effect in net loss from continuing operations	\$ 69,446 =====	\$ 422,397 =====
Basic and diluted loss per common share	\$ (0.00) =====	\$ (0.01) =====

In accordance with SFAS No. 123-R, beginning on April 1, 2006, 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, if any, of adjusting the forfeiture rate for all expense amortization is recognized in the period the forfeiture estimate is changed. The effect of forfeiture adjustments for the three and nine month periods ended December 31, 2007 was insignificant.

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

	Nine Months Ended December 31	
	2007	2006
Annual dividends	zero	zero
Expected volatility	92%	89%
Risk free interest rate	4.72%	4.82%
Expected life	2.14 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

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

grants. Options outstanding that have vested and are expected to vest as of December 31, 2007 are as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value (1)
Vested (2)	9,702,393	\$ 0.39	5.60	\$3,492,861
Expected to vest	2,001,667	0.35	4.30	\$ 800,667
Total	11,704,060			\$4,293,528

(1) These amounts represent the difference between the exercise price and \$0.75, the closing market price of the Company's common stock on December 31, 2007 as quoted on the Over-the-Counter Bulletin Board under the symbol "AEMD.OB" for all in-the-money options outstanding.

(2) 4,278,375 options were granted prior to April 1, 2006 (the date of adoption for SFAS 123-R) and were fully vested at the date of adoption.

Additional information with respect to stock option activity is as follows:

	Shares Available for Grant	Outstanding Options		
		Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (1)
March 31, 2007	467,500	9,204,060	\$ 0.38	\$3,802,324
Grants	--	2,500,000	\$ 0.36	
Exercises	--	--	--	
Cancellations	--	--	--	
December 31, 2007	467,500	11,704,060	\$ 0.38	\$4,330,502
Options exercisable at:				
December 31, 2007		9,702,393	\$ 0.38	

(1) Represents the difference between the exercise price and the March 31, 2007 or December 31, 2007 market price of the Company's common stock, which was \$0.74 and \$0.75, respectively.

At December 31, 2007, there were approximately \$444,000 of unrecognized compensation cost related to share-based payments which is expected to be recognized over a weighted average period of 1.37 years.

INCOME TAXES

Under SFAS 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

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

the foreseeable future, it is more likely than not that some portion of the deferred tax assets may not be realized.

11

SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." FIN No. 48 establishes a single model to address accounting for certain tax positions. FIN No. 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company adopted the provisions of FIN No. 48 on April 1, 2007. Upon adoption, the Company recognized no adjustment in the amount of unrecognized tax benefits. As of the date of adoption the Company had no unrecognized tax benefits. The Company's policy is to recognize interest and penalties that would be assessed in relation to the settlement of unrecognized tax benefits as a component of income tax expense. The Company has recognized approximately \$36,000 in penalties and interest upon the adoption of FIN No. 48.

The Company and its subsidiaries are subject to federal income tax. With few exceptions, the Company is no longer subject to U.S. federal income tax examination for years before 2000; state and local tax examinations before 2000. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carryforward amount.

The Company is not currently under Internal Revenue Service (IRS), state, local or foreign jurisdiction tax examinations.

For the quarter and nine-month periods ended December 31, 2007, the Company recorded no income tax provision.

In December 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 has not yet evaluated the effects on future consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "THE FAIR VALUE OPTION FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES." SFAS No. 159 allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If the Company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Management has not yet evaluated the effects on future consolidated financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Public

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Accountants, and the Securities and Exchange Commission did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

12

NOTE 4. NOTES PAYABLE

At December 31, 2007, the Company had \$502,500 in principal amount of notes payable outstanding with twelve noteholders.

The Company is currently in default on \$502,500 of amounts owed under various unsecured notes payable and is currently seeking other financing arrangements to retire all past due notes. At December 31, 2007 the Company had accrued interest in the amount of \$405,754 associated with these defaulted notes payable.

At December 31, 2007, the Company had \$1,110,000 in principal amount of convertible notes payable outstanding, net of a \$961,000 discount, held by six noteholders. The discount is comprised of \$29,921 in unamortized BCF discount and approximately \$931,000 in unamortized discount attributable to the valuation of warrant rights associated with the issuance of convertible notes.

10% SERIES A CONVERTIBLE NOTES AMENDMENT

On November 2007, the Company entered into Amended and Restated 10% Series A Convertible Promissory Notes (the "Amended Notes") with the holders of certain promissory notes previously issued by the Company (the "Prior Notes"), and all amendments to the Prior Notes, including on March 5, 2007.

The Amended Notes, in the principal amount of \$1,000,000, are convertible into an aggregate of 5,000,000 shares of the Company's Common Stock and mature on February 15, 2009. The Amended Notes provide for the payment of accrued and default interest through December 31, 2007 in the aggregate amount of \$295,248 to be paid in units ("Units") at a fixed rate of \$0.20 per Unit, each Unit consisting of one share of the Company's Common Stock and one Class A Common Stock Purchase Warrant (the "Class A Warrant") to purchase one share of the Company's Common Stock at a fixed exercise price of \$0.20 per share. If the Holders exercise the Class A Warrants on or before February 15, 2010, the Company will issue them one Class B Common Stock Purchase Warrant (the "Class B Warrant") for every two Class A Warrants exercised. The Class B Warrants will have a fixed exercise price of \$0.60 per share.

The Amended Notes also provided for the payment of liquidated damages through November 29, 2007 in the aggregate amount \$269,336 to be paid in units ("Damages Units") at a fixed rate of \$0.40 per Damages Unit, each Damages Unit consisting of one share of the Company's Common Stock and one Class A-1 Common Stock Purchase Warrant (the "Class A-1 Warrant") to purchase on share of the Company's Common Stock at a fixed exercise price of \$0.40 per share. If the Holders exercise the Class A-1 Warrants on or before February 15, 2010, the Company will issue them one Class B-1 Common Stock Purchase Warrant (the "Class B-1 Warrant") for every two Class A-1 Warrants exercised. The Class B-1 Warrants will have a fixed exercise price of \$0.40 per share.

In addition, the Amended Notes provide for the issuance of Class A Principal Common Stock Purchase Warrants (the "Class A Principal Warrant") to purchase an aggregate of 5,000,000 shares of the Company's Common Stock on the same terms as the Class A Warrants.

The following table summarizes the number of shares of the Company's Common Stock issuable upon the conversion of the Amended Notes or the exercise of the

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

various warrants issued or issuable pursuant to the Amended Notes.

Note Conversion	5,000,000
Accrued Interest	1,476,242
Liquidated Damages	673,340
Class A Warrants	1,476,242
Class A-1 Warrants	673,340
Class A Principal Warrants	5,000,000
Class B Warrants	738,121
Class B-1 Warrants	336,670

Total	15,373,955
	=====

The Company is obligated to register the shares underlying the Class A Warrants, the Class A-1 Warrants and the Class A Principal Warrants with the SEC by March 31, 2008, and the shares underlying the Class B Warrants and to register the Class B-1 Warrants with the SEC by the 30th day following the issuance date of such warrants.

13

For accounting purposes, the amendment of the 10% Series A Convertible Notes was treated as an extinguishment pursuant to EITF Issue No. 06-6. The changes in the note agreements, conversion feature and warrants were considered substantive as prescribed in that consensus. Consequently, the Company recorded a loss on extinguishment of \$489,013 as follows:

Reacquisition Price (Fair value of new notes and warrants)	\$ 5,392,664
Less amounts relieved at date of extinguishment:	
Carrying amount of the unamortized note	(166,667)
Carrying amount of derivative liability	(4,172,400)
Accrued interest and liquidated damages	(564,584)

Loss on extinguishment	\$ 489,013
	=====

The new warrants issued in connection with the Amended Notes were evaluated pursuant to EITF Issue No. 00-19 and classified as equity instruments. In connection with the new warrants, the Company recorded \$4,392,664 as an increase to additional paid in capital, based on the estimated fair value at issuance. The amended conversion feature contains a beneficial conversion at the date of the Amended Notes; consequently, the Company recorded a discount of \$1,000,000 against the notes and a corresponding increase in additional paid in capital. Through December 31, 2007, the Company amortized approximately \$69,000 of such discount into interest expense.

\$495,000 NOTE WITH WARRANTS FINANCING

On December 5, 2007, the Company entered into a Subscription Agreement with two accredited investors pursuant to which the Company issued and sold promissory notes in the principal amount of \$495,000 and three-year warrants to purchase an aggregate of 1,485,000 shares of the Registrant's common stock at a fixed exercise price of \$0.50 per share. The promissory notes bear interest compounded monthly at the annual rate of eight percent (8%) and mature on September 5, 2008. The net proceeds to the Company were \$450,000.

The warrants associated with this financing did not meet all of the conditions required for equity classification under EITF Issue No. 00-19; consequently, the

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

warrants (with an estimated fair value of \$693,050) were accounted for as derivative liabilities at issuance. The Company revalued the warrants at December 31, 2007 and the change in the estimated fair value of \$38,224 was recorded to earnings.

NOTE 5. EQUITY TRANSACTIONS

In April 2007, the Company issued 30,617 shares of restricted common stock as the result of a cashless exercise of 80,000 warrants held by a former noteholder.

In April 2007, the Company issued 15,152 shares of restricted common stock at \$0.33 per share in payment of an option agreement valued at \$5,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

In April 2007, the Company issued 8,651 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 April 2007, the Company issued 3,937 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.76 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 2007, the Company issued 13,124 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.76 per share in payment for regulatory affairs consulting services to the Company valued at \$10,000 based on the value of the services.

In May 2007, the Company issued 5,155 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 \$3,000 based on the value of the services.

14

In June 2007, the Company issued 41,999 shares of restricted common stock at between \$0.30 and \$0.74 per share in payment for investor relations services to the Company valued at \$20,000 based on the value of the services.

In June 2007, the Company issued 17,526 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 \$10,200 based on the value of the services.

In June 2007, the Company issued 5,155 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 \$3,000 based on the value of the services.

In June 2007, the Company issued 10,174 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.63 per share in payment for regulatory affairs consulting services to the Company valued at \$6,450 based on the value of the services.

In August 2007, the Company issued 1,630,000 shares of common stock for cash proceeds of \$815,000 (\$757,950 net of commissions). The shares were issued to accredited investors in the form of Units comprised of two shares of common

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

stock and one three-year warrant to acquire common stock at an exercise price of \$0.50. The offering price of each Unit was \$1.00.

In August 2007, the Company issued 14,857 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.60 per share in payment of grant writing consulting services to the Company valued at \$10,500 based upon the value of the services.

In August of 2007, the Company issued 71,045 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 outstanding liabilities related to regulatory consulting services to the Company valued at \$17,051 based upon the value of the services provided.

In August of 2007, the Company issued 13,017 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.49 per share in payment for regulatory consulting services to the Company valued at \$6,413 based upon the value of the services provided.

In August of 2007, the Company issued 103,106 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 of legal fees related to general corporate legal services to the Company valued at \$62,894 based upon the value of the services provided.

In August 2007, the Company issued 21,020 shares of restricted common stock at prices between \$0.68 and \$0.78 per share in payment for investor relations services to the Company valued at \$15,000 based on the value of the services.

In August 2007, the Company issued 8,264 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at prices between \$0.68 and \$0.78 per share in payment for regulatory affairs consulting services to the Company valued at \$6,000 based on the value of the services.

In September 2007, the Company issued 14,000 shares of common stock to an accredited investor at \$0.50 per share in payment of commissions related to the August Private Placement transaction valued at \$7,000 based upon the value of services provided.

In September 2007, the Company issued 5,297 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.68 per share in payment for regulatory affairs consulting services to the Company valued at \$3,600 based on the value of the services provided.

In October 2007, the Company issued 4,601 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.65 per share in payment for regulatory affairs consulting services to the Company valued at \$3,000 based on the value of the services provided.

In December 2007, the Company issued 330,000 Units for cash proceeds of \$165,000. The Units were issued to accredited investors were comprised of two shares of common stock and one three-year warrant to acquire common stock at an exercise price of \$0.50 per share. The offering price of each Unit was \$1.00.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

LEGAL MATTERS

From time to time, claims are made against the Company in the ordinary course of business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting the Company from selling one or more products or engaging in other activities. The occurrence of an unfavorable outcome in any specific period could have a material adverse effect on the Company's results of operations for that period or future periods. The Company is not presently a party to any pending or threatened legal proceedings.

OTHER

The Company has not filed its income tax returns for certain prior periods. Whereas the Company is in the process of remediating this matter, it may be subject to penalties; however, those amounts are not expected to be significant.

NOTE 7. SUBSEQUENT EVENTS

In January 2008, the Company issued 21,992 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at \$0.68 per share in payment for regulatory affairs consulting services to the Company valued at \$15,000 based on the value of the services provided.

In January 2008, the Company entered into a Subscription Agreement with an accredited investor pursuant to which the Company issued and sold promissory notes in the principal amount of \$220,000 and three-year warrants to purchase an aggregate of 660,000 shares of the Registrant's common stock at a fixed exercise price of \$0.50 per share. The promissory notes bear interest compounded monthly at the annual rate of nine percent (9%) and mature on October 19, 2008. The aggregate gross proceeds to the Company were \$200,000.

In January 2008, the Company issued 200,000 shares of common stock for cash proceeds of \$100,000. The shares were issued to an accredited investor in the form of Units comprised of two shares of common stock and one three-year warrant to acquire common stock at a fixed exercise price of \$0.50 per share. The offering price of each Unit was \$1.00.

16

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 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

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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 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>.

17

RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2007 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2006

Operating Expenses

Consolidated operating expenses for the three months ended December 31, 2007 were \$526,975 in comparison with \$464,994 for the comparable quarter a year ago. The increase of \$61,981, or 13% was due primarily to an increase in Payroll & Related expenses of \$64,834, which was largely due to an increase in non-cash stock compensation expense of \$69,446.

Other Expense

Other expenses increased by approximately \$2,000,000 as compared to the

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

corresponding prior period. This increase was comprised of a loss on extinguishment of debt of \$489,013, a non-cash increase in the fair value of warrant liability of approximately \$633,000, and an increase of approximately \$876,000 in interest expense for amortization of note discounts prior to extinguishment of the 10% Series A Convertible Notes, warrants and related obligations (see Note 4 to the condensed consolidated financial statements).

Net Loss

As a result of the increased expenses noted above, the Company recorded a consolidated net loss of approximately \$2,603,000 and \$541,000 for the quarters ended December 31, 2007 and 2006, respectively.

Basic and diluted loss per common share were (\$0.07) for the three month period ended December 31, 2007 compared to (\$0.02) for the same period ended December 31, 2006. This increase in loss per share was primarily a result of the higher net loss during the three month period ended December 31, 2007, as compared to the three month period ended December 31, 2006.

NINE MONTHS ENDED DECEMBER 31, 2007 COMPARED TO THE NINE MONTHS ENDED DECEMBER 31, 2006

Operating Expenses

Consolidated operating expenses were approximately \$2,088,000 for the nine months ended December 31, 2007, versus approximately \$1,504,000 for the comparable period ended December 31, 2006. The increase of approximately \$584,000, or 39%, is a result of approximate increases in Professional expenses of \$74,000, Payroll expenses of \$495,000 and General and Administrative expenses \$15,000.

The Professional Fees expense increase is comprised of increases in legal fees of approximately \$210,000 and \$5,000 in accounting services, offset by approximate decreases of \$46,000 in scientific consulting fees, \$78,000 in investor relations expenses and \$6,000 in directors' fees.

The General and Administrative expense increase is comprised of approximate increases in lab supplies of \$74,000, insurance expense of \$14,000 and utilities expense of \$16,000 offset by decreases in financial conference expense of approximately \$36,000, travel expense of \$26,000, rent expense of \$15,000 and a net reduction in all other general expenses of approximately \$12,000.

The Payroll and related expense increase is comprised of approximately \$103,000 of increases in payroll expense primarily a result of our having a full-time President hired in the middle of the previous period and an approximate increase in stock option compensation expense of \$392,000.

Other Expense

Other expenses increased by approximately \$1,023,000 as compared to the prior period one year ago. This increase was comprised primarily of a loss on extinguishment of debt of \$489,013, and an increase of approximately \$795,000 in interest expense, related to amortization of note discounts, offset by a non-cash decrease in the estimated fair value of the warrant liability of approximately \$281,000.

Net Loss

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

As a result of the increased expenses noted above, the Company recorded a consolidated net loss of approximately \$3,394,000 and \$1,788,000 for the nine-month periods ended December 31, 2007 and 2006, respectively.

Basic and diluted loss per common share were (\$0.10) for the nine month period ended December 31, 2007 compared to (\$0.07) for the same period ended December 31, 2006. This increase in loss per share was attributable primarily to a higher net loss during the nine month period ended December 31, 2007, as compared to the nine-month period ended December 31, 2006.

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, 2007 was approximately \$333,000 compared to approximately \$440,000, at March 31, 2007, representing a decrease of approximately \$107,000. During the nine months ended December 31, 2007, operating activities used net cash of approximately \$1,079,000, while the Company received approximately \$983,000 from financing activities from the issuance of common stock and convertible notes and utilized approximately \$11,000 in connection with patent costs and purchases of new equipment.

During the nine month period ended December 31, 2007, net cash used in operating activities were approximately (\$1,079,000) and resulted from the approximate net loss of \$3,394,000, the change in the estimated fair value of warrant liability of approximately \$3,958,000 and a reduction of accounts payable and accrued expenses of approximately \$439,000. These were offset principally by the non-cash loss on debt extinguishment of approximately \$491,000, amortization of note discount of \$911,000, fair market value of common stock of approximately \$197,000 issued in payment for services and approximately \$422,000 in stock-based compensation.

An increase in working capital during the nine months ended December 31, 2007 in the amount of approximately \$3,584,000 changed the Company's negative working capital position to approximately (\$3,676,000) at December 31, 2007 from a negative working capital of approximately (\$7,260,000) at March 31, 2007.

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 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 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 \$125,000 per month to sustain operations.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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.

19

PLAN OF OPERATION

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 focus is to prepare our Hemopurifier(R) to treat chronic viral conditions, acute viral conditions and viral-based bioterror threats in human clinical trials.

The Company plans to continue research and development activities related to our Hemopurifier(R) platform technology, with particular emphasis on the advancement of our treatment for "Category A" pathogens as defined by the Federal Government under Project Bioshield and the All Hazards Preparedness Act of 2006. The Company has filed an Investigational Device Exemption ("IDE") with the FDA in order to proceed with Human safety studies of the Hemopurifier(R). Such studies, complemented by planned in-vivo and appropriate animal in-vitro studies should allow the Company to proceed to Premarket Approval ("PMA") process. The PMA process is the last major FDA hurdle in determining the safety and effectiveness of Class III medical Devices (of which the Hemopurifier(R) is one).

Subject to the availability of working capital, management anticipates continuing to increase spending on research and development over the next 12 months. Additionally, associated with the Company's anticipated increase in research and development expenditures, we anticipate purchasing additional amounts of equipment during this period to support our laboratory and testing operations. 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 dependent 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.

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

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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 relate to stock purchase warrants issued with notes payable, beneficial conversion feature of convertible notes payable, impairment of intangible assets and long lived assets, stock compensation, classification of warrant obligation, 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, 2007.

20

OFF-BALANCE SHEET ARRANGEMENTS

There are no guarantees, commitments, lease and debt agreements or other agreements that could trigger an adverse change in our credit rating, earnings, cash flows or stock price, including requirements to perform under standby agreements.

ITEM 3. CONTROLS AND PROCEDURES

Under the supervision and with the participation of Management, including our Chief Executive Officer ("CEO"), 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 concluded that, as of December 31, 2007, 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

During the quarter ended December 31, 2007, our chief financial officer resigned and our chief executive officer assumed the role of principal accounting officer. We also hired a part time senior vice president of finance to bolster our financial staff following the departure of our former chief financial officer.

There were no other significant changes made in our internal controls over financial reporting during the three month period ended December 31, 2007 that have materially affected or are reasonably likely to materially affect these controls.

Limitations on the Effectiveness of Internal Control

Management, including the CEO, does not expect that our disclosure controls and

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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 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.

21

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, claims are made against the Company in the ordinary course of business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting the Company from selling one or more products or engaging in other activities. The occurrence of an unfavorable outcome in any specific period could have a material adverse effect on the Company's results of operations for that period or future periods. The Company is not presently a party to any pending or threatened legal proceedings.

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

On November 29, 2007, the Company entered into Amended and Restated 10% Series A Convertible Promissory Notes (the "Notes") with the Holders. The Notes were issued in exchange for the Prior Notes, and all amendments to the Prior Notes, including the Allonges entered into between the Company and the Holders on March 5, 2007.

The Notes bear an aggregate principal amount of \$1,000,000 and are convertible into an aggregate of 5,000,000 shares of the Company's Common Stock and mature on February 15, 2009. The Notes provide for the payment of accrued and default interest through December 31, 2007 in the aggregate amount of \$295,248 to be paid in units ("Units") at a fixed rate of \$0.20 per Unit, each Unit consisting of one share of the Company's Common Stock and one Class A Common Stock Purchase Warrant (the "Class A Warrant") to purchase one share of the Company's Common Stock at a fixed exercise price of \$0.20 per share. If the Holders exercise the Class A Warrants on or before February 15, 2010, the Company will issue them one Class B Common Stock Purchase Warrant (the "Class B Warrant") for every two Class A Warrants exercised. The Class B Warrants will have an exercise price of

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

\$0.60 per share.

The Notes also provide for the payment of liquidated damages through November 29, 2007 in the aggregate amount \$269,336 to be paid in units ("Damages Units") at a fixed rate of \$0.40 per Damages Unit, each Damages Unit consisting of one share of the Company's Common Stock and one Class A-1 Common Stock Purchase Warrant (the "Class A-1 Warrant") to purchase one share of the Company's Common Stock at an exercise price of \$0.40 per share. If the Holders exercise the Class A-1 Warrants on or before February 15, 2010, the Company will issue them one Class B-1 Common Stock Purchase Warrant (the "Class B-1 Warrant") for every two Class A-1 Warrants exercised. The Class B-1 Warrants will have a fixed exercise price of \$0.40 per share.

In addition, the Notes provide for the issuance of Class A Principal Common Stock Purchase Warrants (the "Class A Principal Warrant") to purchase an aggregate of 5,000,000 shares of the Company's Common Stock on the same terms as the Class A Warrants. The shares underlying the Class A Warrants, the Class A-1 Warrants and the Class A Principal Warrants shall be registered with the SEC by March 31, 2008, and the shares underlying the Class B Warrants and the Class B-1 Warrants shall be registered with the SEC by the 30th day following the issuance date of such warrants. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

On December 5, 2007 the Company issued and sold promissory notes in the principal amount of \$495,000 (the "Notes") and three-year warrants to purchase and aggregate of 1,485,000 shares of the Company's common stock at a fixed exercise price of \$.50 per share (the "Warrants"). The Notes bear interest compounded monthly at an annual rate of eight percent (8%) per annum and mature on September 5, 2008. The Company is required to file a registration statement with the SEC covering the shares underlying the Warrants within 60 calendar days of closing. In the event that, within 180 days of closing such registration statement is not effective, the Company is obligated to penalties, payable in cash, of 2% per month. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In December 2007, the Company issued 330,000 Units of common stock for cash proceeds of \$165,000. The shares were issued to accredited investors in the form of Units comprised of two shares of common stock and one three-year warrant to acquire common stock at an exercise price of \$0.50 per share. The offering price of each Unit was \$1.00.

22

In January 2008, the Company issued 200,000 shares of common stock for cash proceeds of \$100,000. The shares were issued to an accredited investor in the form of Units comprised of two shares of common stock and one three-year warrant to acquire common stock at a fixed exercise price of \$0.50 per share. The offering price of each Unit was \$1.00.

That 330,000 unit transaction in December coupled with the sale of 100,000 units in January 2008 (see Note 7 Subsequent Events) completed a private placement of 1,000,000 Units, priced at \$1.00 per unit, raising \$980,000. Each Unit is comprised of two shares of common stock and one warrant. The warrant has a fixed exercise price of \$0.50 per share and is exercisable for three years from issuance. The Company is required to file a registration statement with the SEC covering the shares underlying the units within 60 calendar days of closing. In the event that, within 180 days of closing such registration is not effective, or the underlying shares are not saleable under SEC Rule 144, the Company is obligated to pay penalties, payable in additional shares, of 2% per month. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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, 2007 the Company had accrued interest in the amount of \$405,754 associated with these notes and accrued liabilities payable.

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

None

ITEM 5. OTHER INFORMATION

On January 8, 2008 the Company completed a private placement of 100,000 Units, priced at \$1.00 per unit, raising \$100,000. Each Unit is comprised of two shares of common stock and one warrant. The warrant has an exercise price of \$0.50 and is exercisable for three years from issuance. The Company is required to file a registration statement with the SEC covering the shares underlying the units within 60 calendar days of closing. In the event that, within 180 days of closing such registration is not effective, or the underlying shares are not saleable under SEC Rule 144, the Company is obligated to pay penalties, payable in additional shares, of 2% per month. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

On January 18, 2008 the Company issued and sold promissory notes in the principal amount of \$220,000 (the "Notes") and three-year warrants to purchase and aggregate of 660,000 shares of the Company's common stock at an exercise price of \$.50 per share (the "Warrants"). The Notes bear interest compounded monthly at an annual rate of eight percent (8%) per annum and mature on October 18, 2008. The Company is required to file a registration statement with the SEC covering the shares underlying the Warrants within 60 calendar days of closing. In the event that, within 180 days of closing such registration statement is not effective, the Company is obligated to penalties, payable in cash, of 2% per month. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

23

ITEM 6. EXHIBITS

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

- 3.1 Articles of Incorporation of Aethlon Medical, Inc. (1)
- 3.2 Bylaws of Aethlon Medical, Inc. (1)
- 3.3 Certificate of Amendment of Articles of Incorporation dated March 28, 2000 (2)
- 3.4 Certificate of Amendment of Articles of Incorporation dated June 13, 2005 (3)
- 3.5 Certificate of Amendment of Articles of Incorporation dated March 6, 2007 (4)

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

- 10.32 Form of Registration Rights Agreement for Amended and Restated Notes and Warrants (5)
- 10.33 Form of Class A Warrant (5)
- 10.34 Form of Class A Principal Warrant (5)
- 10.35 Form of Class A-1 Warrant (5)
- 10.37 Form of Class B Warrant (5)
- 10.38 Form of Class B-1 Warrant (5)
- 10.39 Form of Amended and Restated 10% Convertible Notes (5)
- 10.41 Form of Unit Offering Subscription Agreement (5)
- 10.42 Form of Common Stock Warrant (5)
- 10.43 Form of Unit Securities including Promissory Note and Common Stock Purchase Warrant (5)
- 31.1* Certification of Principal Executive Officer and Principal Financial Officer 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, Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

- (1) December 18, 2000 and incorporated by reference
- (2) Filed with the Company's Annual Report on Form 10-KSB for the year ended March 31, 2000 and incorporated by reference.
- (3) Filed with the Company's Current Report on Form 8-K, dated June 10, 2005 and incorporated by reference.
- (4) Filed with the Company's Current Report on form 8-K dated March 7, 2007 and incorporated herein by reference.
- (5) Filed with the Company's Registration Statement on Form S-1 filed February 11, 2008 and incorporated herein by reference.

24

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.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Date: FEBRUARY 19, 2008

BY: /s/ JAMES A. JOYCE

JAMES A. JOYCE
CHAIRMAN, PRESIDENT, CHIEF
ACCOUNTING OFFICER AND
CHIEF EXECUTIVE OFFICER