

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

AETHLON MEDICAL INC
Form 10QSB
February 17, 2004

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, 2003

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

13-3632859

State or other jurisdiction of
incorporation or organization)

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

7825 FAY AVENUE, SUITE 200, LA JOLLA, CA

92037

(Address of principal executive offices)

(Zip Code)

(858) 456-5777

(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 as of February 12, 2004 was 9,122,711.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEET AT DECEMBER 31, 2003 (UNAUDITED)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) FOR THE

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

THREE AND NINE MONTHS ENDED DECEMBER 31, 2003 AND 2002 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2003

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) FOR THE THREE AND NINE MONTHS ENDED DECEMBER 31, 2003 AND 2002 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH DECEMBER 31, 2003

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

ITEM 3. CONTROLS AND PROCEDURES

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

ITEM 2. CHANGES IN SECURITIES

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

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

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

2

PART I. FINANCIAL INFORMATION

All references to "us", "we", "Aethlon", "Aethlon Medical", or "the Company" refer to Aethlon Medical, Inc., its predecessors and its subsidiaries.

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	December 31, 2003 (Unaudited)

ASSETS	
Current assets	
Cash	\$ 5,560
Prepaid expenses	6,401

	11,961
Property and equipment, net	19,028
Patents and patents pending, net	243,163
Other assets	8,905

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

\$ 283,057
=====

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current Liabilities

Accounts payable and accrued liabilities	\$ 1,707,415
Due to related parties	1,594,234
Notes payable	392,500
Convertible notes payable	560,000

	4,254,149

Commitments and Contingencies

Stockholders' Deficit

Common stock, par value \$0.001 per share; 25,000,000 shares authorized; 8,826,627 shares issued and outstanding	8,827
Additional paid-in capital	12,680,007
Deficit accumulated during development stage	(16,659,926)

	(3,971,092)

	\$ 283,057
	=====

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

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Nine Months Ended December 31, 2003 and 2002 and
For the Period January 31, 1984 (Inception) Through December 31, 2003
(Unaudited)

	Three Months Ended December 31, 2003	Three Months Ended December 31, 2002	Nine Months Ended December 31, 2003	Nine Months Ended December 31, 2002
	-----	-----	-----	-----
REVENUES				
Grant income	\$ --	\$ --	\$ --	\$ --
Subcontract income	--	--	--	--
Sale of research and development	--	--	--	--
	-----	-----	-----	-----
	--	--	--	--

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

EXPENSES				
Personnel	101,212	103,635	311,344	401,010
Professional fees	5,386	165,654	141,551	500,820
Impairment	--	--	--	--
Other expenses	82,082	86,181	237,610	247,450
	-----	-----	-----	-----
	188,680	355,470	690,505	1,149,290
OPERATING LOSS	(188,680)	(355,470)	(690,505)	(1,149,290)
OTHER EXPENSE (INCOME)				
Interest and other debt expenses	139,409	50,849	342,906	304,490
Interest income	--	(42)	--	(40)
Other	--	--	--	(1,610)
	-----	-----	-----	-----
	139,409	50,807	342,906	302,840
NET LOSS	(328,089)	(406,277)	(1,033,411)	(1,452,120)
	=====	=====	=====	=====
BASIC AND DILUTED LOSS PER COMMON SHARE	(\$ 0.04)	(\$ 0.07)	(\$ 0.13)	(\$ 0.27)
	=====	=====	=====	=====
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	8,211,717	5,586,904	7,762,130	5,433,000
	=====	=====	=====	=====

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

4

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended December 31, 2003 and 2002 and
For the Period January 31, 1984 (Inception) Through December 31, 2003
(Unaudited)

	Nine Months Ended December 31, 2003	Nine Months Ended December 31, 2002	Janu Dece
	-----	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	\$ (1,033,411)	\$ (1,452,128)	\$ (
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	118,865	118,897	
Gain on sale of property and equipment	--	--	
Fair market value of warrants issued in connection with accounts payable and debt	--	(24,714)	

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

Fair market value of common stock, warrants and options issued for services	2,500	159,000
Beneficial conversion feature of convertible notes payable	150,000	245,700
Impairment of patents pending	--	--
Impairment of goodwill	--	--
Deferred compensation forgiven	--	--
Changes in operating assets and liabilities:		
Prepaid expenses	3,909	117,017
Other assets	(3,300)	(2,150)
Accounts payable and accrued liabilities	176,213	179,442
Due to related parties	179,235	296,175
	-----	-----
Net cash used in operating activities	(405,989)	(362,761)
 CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property and equipment	(4,783)	1,197)
Acquisition of patents and patents pending	--	(19,995)
Proceeds from sale of property and equipment	--	--
Cash of acquired company	--	--
	-----	-----
Net cash used in investing activities	(4,783)	(21,192)

(continued)

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

5

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended December 31, 2003 and 2002 and
For the Period January 31, 1984 (Inception) Through December 31, 2003
(Unaudited)

	Nine Months Ended December 31, 2003	Nine Months Ended December 31, 2002	January 31, 1984 (Inception) Through December 31, 2003
	-----	-----	-----
 CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of notes payable	\$ --	\$ 255,000	\$ 1,480,000
Principal payments on notes payable	(160,000)	(25,000)	(170,000)
Net proceeds from issuance of convertible notes payable	150,000	--	948,000
Net proceeds from issuance of common stock	420,000	74,000	3,574,603
	-----	-----	-----
Net cash provided by financing activities	410,000	304,000	5,832,603
	-----	-----	-----

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

NET (DECREASE) INCREASE IN CASH	(772)	(9,442)	5,560
CASH - beginning of period	6,332	10,667	--
	-----	-----	-----
CASH - end of period	\$ 5,560	\$ 1,225	\$ 5,560
	=====	=====	=====

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

6

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2003

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 (TM) platform technology, which is designed to rapidly reduce the presence of infectious viruses and other toxins from human blood. In this regard, Aethlon Medical's core focus is the development of therapeutic devices that treat HIV/AIDS, Hepatitis-C, and pathogens used in biological warfare and terrorism. In pre-clinical testing, the Company's HIV-Hemopurifier removed 55% of HIV from human blood in three hours and in excess of 85% in twelve hours. This same treatment cartridge was able to remove 90% of toxic proteins that deplete immune cells in one hour. In January of 2003, the Company completed early stage blood studies of its HCV-Hemopurifier, which documented the ability to remove 58 percent of the Hepatitis-C virus from infected blood in two hours. The Company is in the development stage on the Hemopurifier 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 on its current lead product candidate, which may take several years. Since many of the Company's patents were issued in the 1980's, they are scheduled to expire in the near future. Thus, such patents may expire before FDA approval, if any, is obtained.

The Company is classified as a development stage enterprise under accounting principles generally accepted in the United States ("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".

The accompanying unaudited condensed consolidated financial statements of Aethlon Medical, Inc. (the "Company") have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-QSB. 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 accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine-month periods ended December 31, 2003 are not necessarily indicative of the results that may be expected for the year ending March 31, 2004. For further information, refer to the Company's Annual Report on Form 10-KSB for the year ended March 31, 2003, which includes audited financial statements and footnotes as of and for the years ended March 31, 2003 and 2002.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

NOTE 2. 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 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. ("Cell") (collectively hereinafter referred to as the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

7

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2003

STOCK BASED COMPENSATION

At December 31, 2003, the Company has two stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related Interpretations.

No stock-based employee compensation cost is reflected in net loss, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," as amended to stock-based employee compensation.

	2003	2002
	-----	-----
Net loss:		
As reported	\$ (1,033,411)	\$ (1,452,128)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	--	(9,000)
Pro forma	\$ (1,033,411)	\$ (1,461,128)
	=====	=====
Basic and diluted net loss per share:		
As reported	\$ (0.13)	\$ (0.27)
	=====	=====
Pro forma	\$ (0.13)	\$ (0.27)
	=====	=====

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 Statement of Financial Accounting Standards 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. The total potential common shares that have not been included in such computation are approximately 1,260,000 (using the treasury stock method) at December 31, 2003.

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity and is effective (except for certain mandatorily redeemable noncontrolling interests) for financial instruments entered into or modified after May 31, 2003. Otherwise, this pronouncement is effective for public companies at the beginning of the first interim period beginning after June 15, 2003. The Company adopted SFAS No. 150 on the aforementioned effective dates. The adoption of this pronouncement did not have a material impact on the Company's results of operations or financial condition.

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

8

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2003

RECLASSIFICATIONS

Certain reclassifications have been made to the December 31, 2002 financial statement presentation to correspond to the December 31, 2003 format.

NOTE 3. CONVERTIBLE PROMISSORY NOTES

CONVERTIBLE PROMISSORY NOTES

At December 31, 2003, the Company had outstanding convertible notes totaling \$560,000.

In April 2003, the Company issued a convertible note in the amount of \$150,000, bearing interest at 9% per annum, with principal and interest due in June 2003,

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

which is in default. The convertible note may be converted to common stock of the Company at the conversion price of \$0.25 per share at any time at the option of the noteholder. The Company has recorded a beneficial conversion feature ("BCF") of \$150,000 in connection with the issuance of the note and amortized such amount to interest expense during the nine month period ended December 31, 2003.

In December 2003, a noteholder converted \$100,000 of convertible notes and accrued interest in the amount of \$15,416 for 461,667 shares of common stock and 461,667 one-year warrants to purchase common stock at \$0.25 per share.

In January 2004, two noteholders converted \$35,000 of convertible notes and accrued interest in the amount of approximately \$4,521 for 158,084 shares of common stock and 158,084 one-year warrants to purchase common stock at \$0.25 per share.

In February 2004, a noteholder converted \$25,000 of 15% promissory notes for 100,000 shares of common stock and 100,000 one-year warrants to purchase common stock at \$0.25 per share.

As of the date of this report, various promissory and convertible notes payable in the aggregate principal amount of \$892,500 have reached maturity and are past due. The Company is currently seeking other financing arrangements to retire all past due notes.

NOTE 4. 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 a loss of approximately \$16.7 million for the period from January 31, 1984 (Inception) through December 31, 2003. 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. Such factors indicate that the Company may be unable to continue as a going concern for a reasonable period of time. Management is in discussions with potential investors to pursue additional capital infusions into the Company, which management believes are necessary at least until such time that the Company generates sufficient revenues and achieves profitability and positive cash flow.

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 generate sufficient revenue and operating cash flow to meet its obligations on a timely basis.

9

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2003

NOTE 5. COMMITMENTS AND CONTINGENCIES

REGISTRATION RIGHTS AGREEMENTS

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

The Company is obligated under various agreements to register its common stock, including the common stock underlying certain warrants and options. The Company is subject to penalties for failure to register such securities, the amount of which could be material to the Company's financial position, results of operations and cash flows. The Company filed a registration statement on Form SB-2 with the Securities and Exchange Commission in December 2000 to register the necessary securities. However, such registration statement was never declared effective. Management is currently unaware of any potential claims related to the lack of registration and plans to file a revised registration statement as funds to cover registration expenses become available. The Company may incur additional charges in exchange for further waivers through the date of an effective registration statement.

DELINQUENT SEC FILING

The Company's March 31, 2002 Form 10-KSB did not contain certain disclosure items in its Executive Compensation, Security Ownership of Certain Beneficial Owners and Management and Certain Relationships and Related Transactions. Such sections were intended to be incorporated by reference in the Company's proxy statement, which was not filed. The failure to file the proxy statement with the disclosures required in Form 10-KSB constitutes non-compliance with the periodic reporting requirements of the Securities and Exchange Act of 1934 (the "Exchange Act") and, among other things, could result in de-listing of the Company's common stock from the Over-the-Counter Bulletin Board ("OTCBB").

In addition, any owners of the Company's restricted securities who are otherwise eligible to sell such securities under Rule 144 may be temporarily unable to do so until such filing delinquency is cured. The Company intends to file an amendment to its Annual Report on Form 10-KSB for the year ended March 31, 2002 to cure such delinquency.

NOTE 6. STOCK TRANSACTIONS

In October 2003, the Company issued 80,000 shares of restricted common stock at \$0.25 per share for cash totaling \$20,000 in connection with the exercise of warrants.

In November 2003, the Company issued 100,000 shares of restricted common stock at \$0.25 per share for cash totaling \$25,000 in connection with the exercise of warrants.

In November 2003, the Company issued 100,000 shares of restricted common stock at \$0.25 per share for cash totaling \$25,000. In connection with the issuance of such shares, the Company granted the stockholder 100,000 one-year warrants to purchase common stock of the Company at \$0.25 per share.

In December 2003, the Company cancelled 50,000 shares of restricted common stock in conjunction with the mutual cancellation of fund-raising activities that were not rendered. The stock was valued at \$20,000 based on the market price at issuance and common stock has been reduced by such amount in the accompanying financial statements.

In December 2003, the Company issued 20,000 shares of restricted common stock at \$0.25 per share for cash totaling \$5,000. In connection with the issuance of such shares, the Company granted the stockholders 20,000 one-year warrants to purchase common stock of the Company at \$0.25 per share.

In December 2003, the Company issued 120,000 shares of restricted common stock at \$0.25 per share for cash totaling \$30,000 in connection with the exercise of warrants.

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

In December 2003, the Company issued 461,667 shares of restricted common stock at \$0.25 per share in connection with the conversion of \$100,000 10% convertible notes plus accrued interest of \$15,417. In connection with the issuance of such shares, the Company granted the noteholder 461,667 one-year warrants to purchase common stock of the Company at \$0.25 per share.

10

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2003

NOTE 7. SUBSEQUENT EVENTS

On January 20, 2004 the Company entered into a Subscription Agreement (Agreement) with Lion Share Group, Inc. (Lion Share), a Bahamas corporation, under which the Company will issue and sell, and Lion Share will purchase, up to 5,000,000 shares of the Company's common stock, in installment closings, in certain amounts, per share purchase prices, purchase price amounts, and on certain dates, as set forth in the Agreement.

On January 16, 2004, a judgement lien in the amount of \$55,000 was filed against the Company for repayment of a past due note. The Company is in active negotiations with the noteholder to settle the claim.

11

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 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

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

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

Aethlon Medical is a development stage therapeutic device company that has not yet engaged in significant commercial activities. The primary focus of our resources is the advancement of our proprietary Hemopurifier(TM) platform treatment technology, which is designed to rapidly reduce the presence of infectious disease and toxins in the body. Our main focus during fiscal 2004 is to prepare our HIV-Hemopurifier to treat HIV/AIDS, and our HCV-Hemopurifier to treat Hepatitis-C for human clinical trials. We are also working to advance pathogen filtration devices to treat infectious agents used in biological warfare and terrorism. See Item 1, "NATURE OF BUSINESS".

Our principal executive office is located at 7825 Fay Avenue, Suite 200, La Jolla, California 92037. Our telephone number is 858/456-5777, and our website is www.aethlonmedical.com.

We file annual, quarterly, special reports, proxy statements and other information with the Securities Exchange Commission (SEC). Reports, proxy statements and other information filed with the SEC can be inspected and copied at the public reference facilities of the SEC at 450 Fifth Street NW, Washington, DC 20549. Such material may also be accessed electronically by means of the SEC's website at www.sec.gov.

Our common stock, par value \$0.001 per share, is traded on the OTCBB under the symbol "AEMD".

CRITICAL ACCOUNTING POLICIES

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us 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, we evaluate estimates and assumptions based upon historical experience and various other factors and circumstances. We believe our estimates and assumptions are reasonable in the circumstances; however, actual results may differ from these estimates under different future conditions.

12

We believe that the estimates and assumptions that are most important to the portrayal of our financial condition and results of operations, in that they require our 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, 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

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

impact on our future financial conditions or results of operations.

RESULTS OF OPERATIONS

THE THREE MONTHS ENDED DECEMBER 31, 2003 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2002.

OPERATING EXPENSES

Consolidated operating expenses were \$ 188,680 for the three months ended December 31, 2003, versus \$355,470 for the comparable period ended December 31, 2002. This decrease of 46.9% in operating expenses is principally attributable to decreased professional fees due to reduced professionals associated with strategic and financial planning activities. Subject to obtaining the necessary funds, the Company expects future costs to increase due to test and support expenses associated with obtaining regulatory approval of its Hemopurifier.

NET LOSS

We recorded a consolidated net loss of \$328,089 and \$406,277 for the quarters ended December 31, 2003 and 2002, respectively. The decrease in net loss of 19.2% was primarily attributable to reduced operating expenses, partially offset by increased interest expense.

Basic and diluted loss per common share were (\$0.04) for the three month period ended December 31, 2003 compared to (\$0.07) for the same period ended December 31, 2002. This reduction in loss per share was primarily attributable to the decrease in net loss, as well as greater number of common shares outstanding during the three month period ended December 31, 2003, as compared to the three month period ended December 31, 2002.

THE NINE MONTHS ENDED DECEMBER 31, 2003 COMPARED TO THE NINE MONTHS ENDED DECEMBER 31, 2002.

OPERATING EXPENSES

Consolidated operating expenses were \$690,505 for the nine months ended December 31, 2003, versus \$1,149,293 for the comparable period ended December 31, 2002. This decrease of 40% in operating expenses is principally attributable to decreased professional fees and personnel expenses due to reduced professionals associated with strategic and financial planning activities and reduced staff. Subject to obtaining the necessary funds, the Company expects future costs to increase due to test and support expenses associated with obtaining regulatory approval of its Hemopurifier.

NET LOSS

We recorded a consolidated net loss of \$1,033,411 and \$1,452,128 for the nine Month periods ended December 31, 2003 and 2002, respectively. The decrease in net loss of 28.8% was primarily attributable to reduced operating expenses, offset partially by slightly higher interest expense.

Basic and diluted loss per common share were (\$0.13) for the nine month period ended December 31, 2003 compared to (\$0.27) for the same period ended December 31, 2002. This reduction in loss per share was primarily attributable to the decrease in net loss, as well as greater number of common shares outstanding

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

during the nine month period ended December 31, 2003, as compared to the nine month period ended December 31, 2002.

13

LIQUIDITY AND CAPITAL RESOURCES

To date, we have funded our 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. Our cash position at December 31, 2003 was \$5,560 as compared to \$6,332, at March 31, 2003, representing a decrease of \$772.

During the nine months ended December 31, 2003, operating activities used net cash of \$405,989. In our financing activities, we received \$420,000 from the sale of common stock and exercise of warrants. We received \$150,000 from the issuance of a convertible note and we repaid in full a secured promissory note in the amount of \$160,000.

During the nine month period ended December 31, 2003, net cash used in operating activities primarily consisted of net loss of \$1,033,411. Net loss was offset principally by depreciation and amortization of \$118,865, a beneficial conversion feature of \$150,000, increase in accounts payable and accrued liabilities of \$176,213 and an increase in amounts due to related parties of \$179,235.

Changes in current assets and current liabilities of (\$234,713) resulted in a negative working capital position of (\$4,242,188) at December 31, 2003, as compared to a negative working capital of (\$4,007,475) at March 31, 2003.

Our current deficit in working capital requires 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. We are seeking to fund these and other operating needs in the next 12 months from funds to be obtained through a corporate acquisition of or merger with another entity with greater financial resources, or from the proceeds of additional private placements or public offerings of debt or equity securities, or both.

Due to the our recurring losses during the development stage, and continued need for capital, our independent certified public accountants have included an explanatory paragraph in their audit report in the Company's Form 10-KSB at March 31, 2003, stating that these factors raise substantial doubt about the Company's ability to continue as a going concern.

We expect to raise additional capital within the next three months to fund research and development and other activities. Our operations to date have consumed substantial capital without generating revenues, and we will continue to require substantial and increasing capital funds to conduct necessary research and development and pre-clinical and clinical testing of our Hemopurifier products, and to market any of those products that receive regulatory approval. We do 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. Our 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,

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

maintaining and enforcing patent claims and other proprietary rights, the time and costs involved in obtaining regulatory approvals, competing technological and market developments, and our ability to establish collaborative arrangements, effective commercialization, marketing activities and other arrangements. We expect to continue to incur increasing negative cash flows and net losses for the foreseeable future.

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.

14

ITEM 3. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our 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 34 Act) as of a date (the "Evaluation Date") within 90 days prior to the filing date of this report. Based upon that evaluation, the CEO and CFO concluded that, as of December 31, 2003, 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. Based on their most recent evaluation as of the Evaluation Date, the CEO and the CFO have also concluded that there are no significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information, and such officers have identified no material weaknesses in internal controls.

There were no significant changes made in our internal control over financial reporting during the quarter ended December 31, 2003 that are reasonably likely to significantly affect these controls. Thus, no corrective actions with regard to significant deficiencies or material weaknesses were necessary.

15

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On January 16, 2004, a judgement lien in the amount of \$55,000 was filed against the Company for repayment of a past due note. The Company is in active negotiations with the noteholder to settle the claim.

ITEM 2. CHANGES IN SECURITIES

In October 2003, the Company issued 80,000 shares of restricted common stock at

Edgar Filing: AETHLON MEDICAL INC - Form 10QSB

\$0.25 per share for cash totaling \$20,000 in connection with the exercise of warrants.

In November 2003, the Company issued 100,000 shares of restricted common stock at \$0.25 per share for cash totaling \$25,000 in connection with the exercise of warrants.

In November 2003, the Company issued 100,000 shares of restricted common stock at \$0.25 per share for cash totaling \$25,000. In connection with the issuance of such shares, the Company granted the stockholder 100,000 one-year warrants to purchase common stock of the Company at \$0.25 per share.

In December 2003, the Company cancelled 50,000 shares of restricted common stock in conjunction with the mutual cancellation of fund-raising activities that were not rendered. The stock was valued at \$20,000 based on the market price at issuance and common stock has been reduced by such amount in the accompanying financial statements.

In December 2003, the Company issued 20,000 shares of restricted common stock at \$0.25 per share for cash totaling \$5,000. In connection with the issuance of such shares, the Company granted the stockholders 20,000 one-year warrants to purchase common stock of the Company at \$0.25 per share.

In December 2003, the Company issued 120,000 shares of restricted common stock at \$0.25 per share for cash totaling \$30,000 in connection with the exercise of warrants.

In December 2003, the Company issued 461,667 shares of restricted common stock at \$0.25 per share in connection with the conversion of \$100,000 10% convertible notes plus accrued interest of \$15,417. In connection with the issuance of such shares, the Company granted the noteholder 461,667 one-year warrants to purchase common stock of the Company at \$0.25 per share.

In January 2004, the Company issued 158,084 shares of restricted common stock at \$0.25 per share in connection with the conversion of \$35,000 principal amount of 10% convertible notes plus accrued interest of \$4,521. In connection with the issuance of such shares, the Company granted the noteholder 158,084 one-year warrants to purchase common stock of the Company at \$0.25 per share.

In January 2004, the Company issued 12,000 shares of restricted common stock in payment for services of \$4,825.

In February 2004, the Company issued 100,000 shares of restricted common stock at \$0.25 per share in connection with the conversion of \$25,000 principal amount of 15% promissory notes. In connection with the issuance of such shares, the Company granted the noteholder 100,000 one-year warrants to purchase common stock of the Company at \$0.25 per share

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 \$892,500 have reached maturity and are past due. The Company is currently seeking other financing arrangements to retire all past due notes.

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

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

10.1 Subscription Agreement with the Lion Share Group, Inc., dated January 20, 2004.

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 Edward C. Hall, 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.

(b) Reports on Form 8-K filed during the quarter ended December 31, 2003.

None

(c) Previously filed documents:

Articles of Incorporation of Aethlon Medical, Inc.

By-Laws of Aethlon Medical, Inc.

Form of Promissory Note

Registration Rights Agreement

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 17, 2004

BY: /S/ JAMES A. JOYCE

JAMES A. JOYCE
CHAIRMAN, PRESIDENT AND
CHIEF EXECUTIVE OFFICER

BY: /S/ EDWARD C. HALL

EDWARD C. HALL
CHIEF FINANCIAL OFFICER

