AETHLON MEDICAL INC
Form 10-Q
August 13, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

o 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 000-21846

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.)

8910 UNIVERSITY CENTER LANE, SUITE 660, SAN DIEGO, CA 92122

(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 x NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (ss.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES S NO £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company x
(Do not check if a smaller reporting company)	

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

As of August 13, 2013, the registrant had outstanding 190,011,783 shares of common stock, $.001 par value.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2013 (Unaudited)	March 31, 2013
ASSETS		
Current assets		
Cash	$31,653	$125,274
Accounts receivable	–	208,781
Deferred financing costs	–	863
Prepaid expenses and other current assets	33,852	29,602
Total current assets	65,505	364,520
Property and equipment, net	–	145
Patents and patents pending, net	119,362	121,653
Deposits	10,376	10,376
Total assets	$195,243	$496,694
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities		
Accounts payable	$972,420	$822,832
Due to related parties	798,778	736,070
Notes payable	235,296	321,381
Convertible notes payable, net of discounts	2,260,164	2,367,631
Derivative liabilities	2,886,257	3,588,239
Accrued liquidated damages	437,800	437,800
Other current liabilities	1,424,786	1,367,185
Total current liabilities	9,015,501	9,641,138
Commitments and Contingencies (Note 13)		
Stockholders' Deficit		
Common stock, par value $0.001 per share; 500,000,000 shares authorized as of June 30, 2013 and March 31, 2013; 182,552,460 and 173,674,201 shares issued and outstanding as of June 30, 2013 and March 31, 2013, respectively	182,555	173,685

Additional paid-in capital	52,776,011	52,157,196
Accumulated deficit	(61,778,824)	(61,475,325)
Total stockholders’ deficit	(8,820,258)	(9,144,444)
Total liabilities and stockholders' deficit	$195,243	$496,694

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three Months Ended June 30, 2013 and 2012

(Unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012
REVENUES		
Government contract revenue	$195,596	$216,747
OPERATING EXPENSES		
Professional fees	324,070	477,121
Payroll and related	458,631	554,095
General and administrative	196,693	176,337
Total operating expenses	979,394	1,207,553
OPERATING LOSS	(783,798)	(990,806)
OTHER EXPENSE (INCOME)		
Gain on change in fair value of derivative liability	(609,125)	(687,600)
Interest and other debt expenses	106,096	688,645
Interest income	(60)	(45)
Loss on settlement of notes	22,789	24,978
Total other (income) expense	(480,300)	25,978
NET LOSS	$(303,498)	$(1,016,784)
BASIC AND DILUTED LOSS PER COMMON SHARE	$(0.00)	$(0.01)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC AND DILUTED	176,221,634	126,315,501

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended June 30, 2013 and 2012

(Unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012
Cash flows from operating activities:		
Net loss	$(303,498)	$(1,016,784)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,436	2,752
Stock based compensation	115,788	169,299
Non cash interest expense	–	11,846
Fair market value of common stock, warrants and options issued for services	21,750	124,182
Change in fair value of derivative liabilities	(609,125)	(687,600)
Loss on settlement of note	22,789	24,978
Amortization of debt discount and deferred financing costs	2,896	484,223
Changes in operating assets and liabilities:		
Accounts receivable	208,781	400,114
Prepaid expenses and other current assets	(4,250)	(32,851)
Accounts payable and other current liabilities	258,104	209,602
Due to related parties	62,708	(10,000)
Net cash used in operating activities	(221,621)	(320,239)
Cash flows from investing activities:	–	–
Purchases of property and equipment	–	–
Net cash used in investing activities	–	–
Cash flows from financing activities:		
Principal repayments of notes payable	–	(29,610)
Proceeds from the issuance of common stock	128,000	802,000
Net cash provided by financing activities	128,000	772,390
Net (decrease) increase in cash	(93,621)	452,151
Cash at beginning of period	125,274	143,907
Cash at end of period	$31,653	$596,058

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

For the Three Months Ended June 30, 2013 and 2012

(Unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$–	$2,821
Income taxes	$–	$–
Supplemental disclosures of non-cash investing and financing activities:		
Debt and accrued interest converted to common stock	246,500	767,467
Reclassification of accounts payable to convertible note payable	47,000	–
Reclassification of note payable to convertible note payable	–	75,000
Reclassification of warrant derivative liability into equity	92,857	26,543

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2013

NOTE 1. NATURE OF BUSINESS AND BASIS OF PRESENTATION

Aethlon Medical, Inc. ("Aethlon", the "Company", "we" or "us") is a medical device company focused on creating innovative devices that address unmet medical needs in cancer, infectious disease and other life-threatening conditions. At the core of our developments is the Aethlon ADAPT™ (Adaptive Dialysis-Like Affinity Platform Technology) system, a medical device platform that converges single or multiple affinity drug agents with advanced plasma membrane technology to create therapeutic filtration devices that selectively remove harmful particles from the entire circulatory system without loss of essential blood components. On June 25, 2013, the United States Food and Drug Administration (FDA) approved an Investigational Device Exemption (IDE) that allows us to initiate human feasibility studies of the Aethlon Hemopurifier® in the United States. Under the feasibility study protocol, we will enroll ten end-stage renal disease patients who are infected with the Hepatitis C virus (HCV) to demonstrate the safety of Hemopurifier therapy. Successful completion of this study will allow us the opportunity to initiate pivotal studies that are required for market clearance to treat HCV and other disease conditions in the United States.

Successful outcomes of human trials will also be required by the regulatory agencies of certain foreign countries where we intend to sell this device. Some of our patents may expire before FDA approval or approval in a foreign country, if any, is obtained. However, we believe that certain patent applications and/or other patents issued more recently will help protect the proprietary nature of the Hemopurifier(R) treatment technology.

Our common stock is quoted on the Over-the-Counter Bulletin Board administered by the Financial Industry Regulatory Authority ("OTCBB") under the symbol "AEMD.OB."

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and applicable sections of Regulation S-X. 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 necessary to make the financial statements not misleading have been included. The condensed consolidated balance sheet as of March 31, 2013 was derived from our audited financial statements. Operating results for the three months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending March 31, 2014. For further information, refer to our Annual Report on Form 10-K for the year ended March 31, 2013, which includes audited financial statements and footnotes as of March 31, 2013 and for the years ended March 31, 2013 and 2012.

NOTE 2. LIQUIDITY

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. We have experienced continuing losses from operations, are in default on certain debt, have negative working capital of approximately $8,950,000, recurring losses from operations and an accumulated deficit of approximately $61,779,000 at June 30, 2013, which among other matters, raises significant doubt about our ability to continue as a going concern. We have 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 our products to the point at which they may become commercially viable. We intend to fund operations, 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, 2014 through debt and/or equity financing arrangements as well as through the receipts under our original DARPA contract and the related subcontract with Battelle (See Note 12).

We are currently addressing our liquidity issue by seeking additional investment capital through private placements of common stock and debt and by applying for additional grants issued by government agencies in the United States.

We recently signed an agreement with a broker-dealer to raise operating capital to cover near term operating requirements and the expected costs of our US safety trial. The agreement also calls for the broker-dealer to raise additional working capital in a larger transaction for future growth initiatives (see note 2). Any securities offered will not be registered under the Securities Act and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. The engagement agreement is on a best efforts basis and there can be no assurance that the broker-dealer can raise working capital for us on acceptable terms or at all.

We believe that our cash on hand and funds expected to be received from additional private investment and/or government grants will be sufficient to meet our liquidity needs for fiscal 2014. However, no assurance can be given that we will receive any funds in addition to the funds we have received to date.

The unaudited condensed consolidated financial statements do not include any adjustments relating to the recoverability of assets that might be necessary should we be unable to continue as a going concern.

NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The summary of our significant accounting policies presented below is designed to assist the reader in understanding our condensed consolidated financial statements. Such financial statements and related notes are the representations of our management, who are 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 wholly-owned subsidiary, Exosome Sciences, Inc. (collectively hereinafter referred to as the "Company" or "Aethlon"). There exist no material intercompany transactions or balances between Aethlon and its subsidiary.

LOSS PER COMMON SHARE

Basic loss per common share is computed by dividing net loss available to common stockholders by the weighted average number of common shares assumed to be outstanding during the period of computation. Diluted loss per common share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued, and if the additional common shares were dilutive. As we had net losses for all periods presented, basic and diluted loss per common share are the same, since additional potential common shares have been excluded as their effect would be antidilutive.

The potentially dilutive common shares outstanding for the quarters ended June 30, 2013 and 2012, which include common shares underlying outstanding stock options, warrants and convertible debentures, were 138,279,424 and 135,921,754, respectively.

PATENTS

We capitalize the cost of patents, some of which were acquired, and amortize such costs over the estimated useful life, upon issuance of the patent.

RESEARCH AND DEVELOPMENT EXPENSES

We incurred research and development expenses during the three month periods ended June 30, 2013 and 2012, which are included in various operating expense line items in the accompanying condensed consolidated statements of operations. Our research and development expenses in those periods were as follows:

	June 30, 2013	June 30, 2012
Three months ended	$337,920	$291,866

FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of certain convertible notes and related warrants at June 30, 2013 and March 31, 2013 are $2,886,257 and $3,588,239, respectively, based upon a third party valuation report that we commissioned. Warrants classified as derivative liabilities are reported at their estimated fair value, with changes in fair value being reported in current period results of operations.

EQUITY INSTRUMENTS FOR SERVICES PROVIDED BY PARTIES OTHER THAN EMPLOYEES

We account for transactions involving goods and services provided by third parties where we issue equity instruments as part of the total consideration 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.

In transactions, when the value of the goods and/or services is 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, we use 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, we re-measure the consideration at each reporting date based on its then current stock value.

IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS

We review our long-lived assets 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. We believe that no impairment occurred at or during the three months ended June 30, 2013 and 2012.

BENEFICIAL CONVERSION FEATURE OF CONVERTIBLE NOTES PAYABLE

The convertible feature of certain notes payable provides for a rate of conversion that is below the market value of our common stock. Such feature is normally characterized as a "Beneficial Conversion Feature" ("BCF"). We record the estimated fair value of the BCF, when applicable, in the condensed consolidated financial statements as a discount from the face amount of the notes. Such discounts are accreted to interest expense over the term of the notes using the effective interest method.

DERIVATIVE LIABILITIES AND CLASSIFICATION

We evaluate free-standing derivative instruments (or embedded derivatives) to properly classify such instruments within equity or as liabilities in our financial statements. Our policy is to settle instruments indexed to our common shares on a first-in-first-out basis.

The classification of a derivative instrument is reassessed at each balance sheet date. If the classification changes as a result of events during a reporting period, the instrument is 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.

On April 1, 2009 we adopted new guidance, as codified in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815-40, *Derivatives and Hedging*, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* (previously EITF 07-5), that requires us to apply a two-step model in determining whether a financial instrument or an embedded feature is indexed to our own stock and thus enables it to qualify for equity classification. We have identified several convertible debt or warrant agreements in which the embedded conversion feature or exercise price contains certain provisions that may result in an adjustment of the conversion or exercise price, which results in the failure of the these instruments to be considered to be indexed to our stock. Accordingly, under this guidance, we are required to record the estimated fair value of these instruments as derivative liabilities (see Note 9).

We re-measure the estimated fair value of derivative liabilities at each reporting period and record changes in fair value in other expense (income) in the current statement of operations.

REGISTRATION PAYMENT ARRANGEMENTS

We account for contingent obligations to make future payments or otherwise transfer consideration under a registration payment arrangement separately from any related financing transaction agreements, and any such contingent obligations are recognized only when it is determined that it is probable that the Company will become obligated for future payments and the amount, or range of amounts, of such future payments can be reasonably estimated (see Note 7).

STOCK-BASED COMPENSATION

Employee stock options and rights to purchase shares under stock participation plans are accounted for under the fair value method. Accordingly, share-based compensation is measured when all granting activities have been completed, generally the grant date, based on the fair value of the award. 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 OTCBB) on the date of grant. Compensation cost recognized by the Company 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 the then current accounting standards, 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 subsequent accounting standards. We use a Binomial Lattice option pricing model for estimating fair value of options granted (see Note 10).

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. We record a valuation allowance for deferred tax assets when, based on our best estimate of taxable income (if any) in the foreseeable future, it is more likely than not that some portion of the deferred tax assets may not be realized.

SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS

There were no recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Public Accountants, or the Securities and Exchange Commission during the three months ended June 30, 2013 or that were issued in prior periods but do not become effective until future periods that in the opinion of management had, or are expected to have a material impact on our present or future consolidated financial statements.

NOTE 4. NOTES PAYABLE

Notes payable consist of the following:

	June 30, 2013		March 31, 2013	
	Principal Balance	Accrued Interest	Principal Balance	Accrued Interest
12% Notes payable, past due	$185,000	$333,000	$185,000	$326,062
10% Note payable, past due	5,000	6,000	5,000	5,875
Tonaquint Note	45,296	543	131,381	1,629
Total	$235,296	$339,543	$321,381	$333,566

During the three month periods ended June 30, 2013 and 2012, we recorded interest expense of $9,891 and $13,029, respectively, related to the contractual interest rates of our notes payable.

12% NOTES

From August 1999 through May 2005, we entered into various borrowing arrangements for the issuance of notes payable from private placement offerings (the "12% Notes"). On April 21, 2010, a holder of $100,000 of the 12% Notes converted his principal balance and $71,758 of accrued interest into 687,033 shares of common stock at an agreed conversion price of $0.25 per share. We incurred a loss upon this conversion of $68,703 since the closing price of our common stock was $0.35 at the date of conversion. At June 30, 2013, the 12% Notes were past due, in default, and bearing interest at the default rate of 15%.

10% NOTES

At June 30, 2013, one 10% Note in the amount of $5,000, which is past due and in default, remained outstanding and it bears interest at the default rate of 15%.

Management's plans to satisfy the remaining outstanding balance on these 12% and 10% Notes include converting the notes to common stock at market value or repayment with available funds.

TONAQUINT NOTE

On June 28, 2011, in conjunction with our satisfying all balances owed under a convertible note, we entered into a Termination Agreement with Tonaquint, Inc. under which both parties agreed that in consideration of the termination of a warrant, the waiving of all fees, penalties, the creation of the selling program and other factors, we agreed to issue an unsecured non-convertible promissory note (the "New Note") in the principal amount of $360,186, which provides for annual interest at a rate of 6%, payable monthly in either cash or our stock, at our option. The New Note originally had a maturity date of April 30, 2012.

We subsequently extended the note initially to July 31, 2012 and then to July 31, 2013 and subsequently to August 31, 2013 (see Note 14) and converted $236,305 of the principal of the note into common stock (see Note 6). We also recorded into principal $7,500 of the lender’s legal fees related to documentation of the extension agreement. During the three months ended June 30, 2013, we recorded a loss on conversion of $22,789 on those partial conversions.

NOTE 5. CONVERTIBLE NOTES PAYABLE

Convertible notes payable consist of the following at June 30, 2013:

	Principal	Unamortized Discount	Net Amount	Accrued Interest
Amended and Restated Series A 12% Convertible Notes, past due	$885,000	$ –	$885,000	$442,500
December 2006 10% Convertible Notes, past due	17,000	–	17,000	16,525
2008 10% Convertible Notes, past due	25,000	–	25,000	16,354
October & November 2009 10% Convertible Notes, past due	50,000	–	50,000	21,722
April 2010 10% Convertible Note	75,000	(2,251)	72,749	25,823
September 2010 10% Convertible Notes, past due	308,100	–	308,100	63,946
April 2011 10% Convertible Notes, past due	400,400	–	400,400	115,115
July and August 2011 10% Convertible Notes, $257,656 past due	357,655	–		