Zendesk, Inc.
Form 4
December 31, 2014

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

(Print or Type Responses)

1. Name and Address of Reporting Person *
Price Matthew Adrian

(Last) (First) (Middle)

1019 MARKET STREET

(Street)

SAN FRANCISCO, CA 94103

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Zendesk, Inc. [ZEN]

3. Date of Earliest Transaction (Month/Day/Year)
12/29/2014

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
SVP of Global Marketing

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	12/29/2014		M[(1)]		7,376	A	$ 0.61	7,376	D	
Common Stock	12/29/2014		M[(1)]		2,416	A	$ 2.3	9,792	D	
Common Stock	12/29/2014		M[(1)]		958	A	$ 9.52	10,750	D	
Common Stock	12/29/2014		S[(1)]		7,176	D	$ 24.4192 [(2)]	3,574	D	
Common Stock	12/29/2014		S[(1)]		3,574	D	$ 25.008 [(3)]	0	D	

Common Stock	12/30/2014	M[(1)]	7,386	A	$ 0.61	7,386	D	
Common Stock	12/30/2014	M[(1)]	1,596	A	$ 2.3	8,982	D	
Common Stock	12/30/2014	M[(1)]	958	A	$ 9.52	9,940	D	
Common Stock	12/30/2014	S[(1)]	9,940	D	$ 24.3632 [(4)]	0	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. D Sec (In
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Stock Option (Right to Buy)	$ 0.61	12/29/2014		M[(1)]			7,376	[(5)]	05/19/2021	Common Stock	7,376	
Stock Option (Right to Buy)	$ 2.3	12/29/2014		M[(1)]			2,416	[(6)]	07/18/2022	Common Stock	2,416	
Stock Option (Right to Buy)	$ 9.52	12/29/2014		M[(1)]			958	[(7)]	02/13/2024	Common Stock	958	
Stock Option (Right to Buy)	$ 0.61	12/30/2014		M[(1)]			7,386	[(5)]	05/19/2021	Common Stock	7,386	

Stock Option (Right to Buy)	$ 2.3	12/30/2014		M[(1)]	1,596	[(6)]	07/18/2022	Common Stock	1,596
Stock Option (Right to Buy)	$ 9.52	12/30/2014		M[(1)]	958	[(7)]	02/13/2024	Common Stock	958

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Price Matthew Adrian 1019 MARKET STREET SAN FRANCISCO, CA 94103			SVP of Global Marketing	

Signatures

/s/ John Geschke, Attorney-in-Fact for Matthew Adrian Price	12/31/2014
**Signature of Reporting Person	Date

Explanation of Responses:

***** If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

****** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) This transaction was effected pursuant to a Rule 10b5-1 trading plan adopted by the Reporting Person.

(2) The sale price reported in column 4 of Table 1 represents the weighted average sale price of the shares sold ranging from $23.92 to $24.89 per share. Upon request by the Commission staff, the Issuer, or a security holder of the Issuer, the Reporting Person will provide full information regarding the number of shares sold at each separate price.

(3) The sale price reported in column 4 of Table 1 represents the weighted average sale price of the shares sold ranging from $24.94 to $25.01 per share. Upon request by the Commission staff, the Issuer, or a security holder of the Issuer, the Reporting Person will provide full information regarding the number of shares sold at each separate price.

(4) The sale price reported in column 4 of Table 1 represents the weighted average sale price of the shares sold ranging from $24.00 to $24.77 per share. Upon request by the Commission staff, the Issuer, or a security holder of the Issuer, the Reporting Person will provide full information regarding the number of shares sold at each separate price.

(5) 1/4th of the shares subject to the option vested on May 5, 2012 and 1/48th of the shares subject to the option shall vest monthly thereafter, subject to the Reporting Person's continuous service to the Issuer on each such date. 50% of the then unvested shares are subject to acceleration upon the occurrence of certain events.

(6) 1/5th of the shares subject to the option vested on July 18, 2013 and 1/60th of the shares subject to the option shall vest monthly thereafter, subject to the Reporting Person's continuous service to the Issuer on each such date. 50% of the then unvested shares are subject to acceleration upon the occurrence of certain events.

(7) The option is immediately exercisable as of the grant date. 1/60th of the shares vest monthly after the vesting commencement date of February 13, 2014, subject to the Reporting Person's continuous service to the Issuer on each such date. 50% of the then unvested shares are subject to acceleration upon the occurrence of certain events. Unvested shares exercised are subject to a right of repurchase in favor of the Issuer should the Reporting Person cease to provide continuous service.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. th the warrants being initially classified as a derivative liability. The derivative liability was

reclassified as additional paid in capital upon obtaining an effective registration statement in January 2006 and the discount will be expensed when the warrants are issued when future debt conversions occur. The convertible feature of the Bird Series A Note provides for a rate of conversion that is below market value. Pursuant to EITF 98-5 and EITF 00-27, the Company has estimated the fair value of such BCF to be $42,000 and records such amount as a debt discount. Such discount is being accreted to interest expense over the term of the Bird Series A Note. Total interest expense on the Bird Series A Note for amortization of the above BCF debt discount totaled $7,783 and $9,271 for the three months and nine months ended December 31, 2005, respectively. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. On December 15, 2005, the Company received total cash investments of $15,000 from two related accredited investors (Christian Hoffmann III and Claypoole Capital, LLC). Such investments were documented in two 10% Series A Convertible Notes ("December Notes"). The December Notes accrue interest at a rate of ten percent (10%) per annum and mature on January 2, 2007. The December Notes are convertible into shares of restricted common stock at any time at the election of the holder at a conversion price of $0.20 per share for any conversion occurring on or before the maturity date. In addition, upon conversion, the Company is obligated to issue three-year Warrants (the "December 11 Warrants") to purchase a number of shares equal to the number of shares into which the December Notes were converted at an exercise p rice of $0.20. The December Warrants have been valued using a Binomial Lattice option pricing model and an associated discount of $15,000, measured at the commitment date, with the warrants being initially classified as a derivative liability. The derivative liability was reclassified as additional paid in capital upon obtaining an effective registration statement in January 2006 and the discount will be expensed when the warrants are issued upon the occurance of future debt conversion. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. On March 23, 2006, the Company retired its $30,000 Aethlon Medical, Inc. Convertible Promissory Note dated May 16, 2005 ("Note")with Fusion Capital Fund II, LLC. The Note plus accrued interest of $4,943.19 Was exchanged for 174,716 shares of restricted common stock valued at $0.20 a share as per the terms of the Note. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. COMMON STOCK AND WARRANTS In April 2004, the Company issued 500,000 shares of restricted common stock to an accredited individual investor in connection with the exercise of warrants at $0.25 per share for cash totaling $125,000. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In April 2004, the Company issued 17,143 shares at $1.75 per share to an accredited individual investor for investor relations services in the amount of $30,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In April 2004, the Company issued 50,000 shares of restricted common stock to Fusion Capital Fund II, LLC, a accredited institutional investor, for a financing commitment to provide $6,000,000 under a registered private placement. In connection with the $6,000,000 financing the Company paid a fee to Fusion Capital in the amount of 418,604 shares of common stock. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In May 2004, the Company issued 225,000 shares of common stock at $0.44 per share and 225,000 warrants to purchase our common stock at a price of $0.76 per share to legal counsel for legal services in the amount of approximately $99,000. This transaction was exempt from registration pursuant to Section 4(2)of the Securities Act of 1933. In May 2004, a $50,000 10% convertible note was converted at $0.44 per share for 113,636 shares of common stock and 113,636 warrants to purchase our common stock at a price of $0.76 per share. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In May 2004, we issued fourteen accredited investors a total of 1,529,545 shares of restricted stock at a price of $0.44 per share for cash totaling $673,000. In connection with the issuance of these shares, we granted the stockholders 1,529,545 warrants to purchase our common stock at a price of $0.76 per share. The warrants vested immediately and expire on fifth anniversary from the date of a registration statement covering the common stock underlying such warrants is declared effective. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In July 2004, we issued 10,715 shares of restricted common stock at $0.70 per share to an accredited individual for employee placement services in the amount of $7,500. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In July 2004, we issued 6,850 shares of restricted common stock at $0.73 per share to an accredited individual for consulting services on opportunities for our Hemopurifier(TM) within the biodefense marketplace in the amount of $5,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In August 2004, we issued a one-year warrant to purchase 7,000 shares of common stock at

$0.55 per share to an accredited corporate entity in conjunction with a $6,000 fee for investor and public relations services. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, In September 2004, we issued 479,513 shares of restricted common stock to LH Financial (Esquire Trade and Finance), an accredited investor, in conjunction with the conversion of $125,000 in principal amount of notes, plus accrued interest, at $0.34 per share, in accordance with their convertible note agreement. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. 12 In October 2004, we issued two $40,000 10% one year promissory notes each with 80,000 three-year warrants to purchase common stock at $0.50 and 44,444 three-year warrants to purchase common stock at $0.90 for cash in the total amount of $80,000 to two accredited individual investors. In accordance with GAAP, the proceeds of the financing have been allocated to the debt and the warrants, based on their relative fair values. Accordingly, a discount of $46,000 has been recorded as a reduction in the debt balance, and the off-setting credit has been recorded as additional paid-in capital. The debt discount is amortized and charged to interest expense over the life of the debt. At March 31, 2004, approximately $23,000 of such discount was unamortized and is included in notes payable in the accompanying consolidated balance sheet. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In October 2004, we issued a $50,000 10% one-year promissory note plus 100,000 three-year warrants to purchase common stock at $0.50 and 55,555 three-year warrants to purchase common stock at $0.90 for cash in the amount of $50,000 to an accredited individual investor. In accordance with GAAP, the proceeds of the financing have been allocated to the debt and the warrants, based on their relative fair values. Accordingly, a discount of $38,000 has been recorded as a reduction in the debt balance, and the off-setting credit has been recorded as additional paid-in capital. The debt discount is amortized and charged to interest expense over the life of the debt. At March 31, 2005, approximately $22,000 of such discount was unamortized and is included in notes payable in the accompanying consolidated balance sheet. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In November 2004, we issued 60,000 shares of restricted common stock to an accredited individual investor in connection with the exercise of 60,000 warrants at $0.25 per share for consideration of a $15,000 reduction in the principal amount of a 10% one-year promissory note. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In December 2004, the Company issued 461,667 shares of restricted common stock to two accredited individual investors in connection with the exercise of 461,667 warrants at $0.25 per share held by an institutional investor. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In December 2004, the Company repaid two $25,000 12% promissory notes, including accrued interest, through the issuance of 87,303 restricted common shares at $0.49 per share to each of two separate accredited individual investors. These transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In December 2004, the Company issued 20,000 shares of restricted common stock to an accredited individual investor in connection with the exercise of a warrant to purchase 20,000 shares of common stock at $0.25 per share for consideration of a $5,000 reduction in the principal amount of a 10% one-year note, resulting in a remaining note balance of $30,000 at December 31, 2004. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In December 2004, the Company issued 60,000 shares of restricted common stock at $0.50 per share under a consulting agreement with an accredited individual investor, for investor relations consulting services to the Company. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In January 2005, the Company issued 55,556 shares of restricted common stock at $0.36 per share and a warrant to purchase 55,556 shares of common stock at $0.44 per share for cash in the amount of $20,000 to an accredited individual investor. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In January 2005, the Company issued 66,666 shares of restricted common stock at $0.45 per share to an accredited individual investor under a consulting agreement for investor relations consulting services to the Company. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In January 2005, the Company issued 25,834 shares of restricted common stock to an accredited individual investor in connection with the exercise of a warrant to purchase 25,834 shares of common stock at $0.25 per share. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In February 2005, the Company issued 139,063 shares of restricted common stock to an accredited individual investor in connection with the exercise of a warrant to purchase 139,063 shares of common stock at $0.25 per share. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. 13

In February 2005, the Company issued 90,000 shares of restricted common stock at $0.27 per share and a three-year warrant to purchase 90,000 shares of common stock at $0.34 per share for cash in the amount of $24,300 to an accredited individual investor. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. During the year ended March 31, 2005, the Company issued an additional total of 1,416,958 shares of restricted common stock at prices ranging from $0.25 to $0.52 for total cash proceeds of approximately $541,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. During the year ended March 31, 2005, the Company issued an additional 557,647 shares of restricted common stock at prices ranging from $0.25 to $0.55 under various consulting service agreements for total recorded value of approximately $196,000. All services on these agreements were completed and expensed during the year ended March 31, 2005. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In May 2005 the Company issued 100,000 shares of common stock and a warrant to purchase 400,000 shares of common stock at a purchase price of $0.176 per share to an accredited investor for $17,600. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In June 2005, the Company issued 836,730 shares of restricted common stock and a three-year warrant to purchase 418,365 shares of the Company's restricted common stock at an exercise price of $0.25 to legal counsel as an inducement to settle accrued past due legal services payable in the amount of $167,346 which had been expensed in the prior fiscal year. At the time of the settlement, the shares of the Company's restricted common stock were valued at $209,183 and, using a Black-Scholes option pricing model, the warrant was valued at $100,408. The non-cash additional consideration of $142,245 has been recorded as professional fees expense during the quarter ended June 30, 2005. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In September 2005, the Company issued 27,852 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.206 per share in payment for regulatory affairs consulting services to the Company valued at $5,738. On September 9, 2005, the Company granted 2,857,143 options to James A. Joyce, its Chief Executive Officer, in exchange for $300,000 of accrued related-party liabilities. The fair value of such options approximated the value of the accrued related-party liability. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In December 2005, the Company issued 73,964 shares of restricted common stock at $0.246 per share in payment of legal fees related to capital raising transactions valued at $18,202. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In January 2006, the Company issued 579,813 shares of restricted common stock at $0.24 per share in payment for patent fees valued at $139,155. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In January 2006, the Company issued 66,017 shares of restricted common stock at Prices ranging from $0.28 to $0.33 per share in payment for investor relations. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. During March 2006, the Company issued 568,181 shares of common stock, at $0.76 per share, to Fusion Capital for total proceeds of $431,818. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In March 2006, the Company repaid a $30,000 10% promissory notes, including accrued interest of $4,564, through the issuance of 140,000 restricted common shares at $0.25 per share to an accredited individual investor. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In March 2006, a $30,000 15% convertible note was converted at $0.20 per share for 174,716 shares of common stock at a price of $0.20 per share. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. 14 In March 2006, the Company issued 150,000 shares of restricted common stock at $0.326 per share in payment of profession services related to investor relations valued at $49,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In March 2006, the Company issued 35,714 shares of restricted common stock at $0.28 per share in payment of profession services related to investor relations valued at $10,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In March 2006, the Company issued 15,152 shares of restricted common stock at $0.33 per share in payment of profession services related to investor relations valued at $5,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In March 2006, the Company issued 33,333 shares of restricted common stock at $0.33 per share in payment of an option agreement valued at $10,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. EQUITY COMPENSATION PLANS SUMMARY EQUITY COMPENSATION PLAN DATA The following table sets forth March 31, 2006 information on our equity

compensation plans (including the potential effect of debt instruments convertible into common stock) in effect as of that date: (a) (b) (c) Plan category Number of securities to Weighted-average Number of securities be issued upon exercise exercise price of remaining available of outstanding options, outstanding options, for future issuance warrants and rights (1)(2) warrants and rights under equity compensation plans (excluding securities reflected in column (a)) Equity compensation plans approved by security holders 32,500 $2.65 467,500 Equity compensation plans not approved by security holders (1) 22,155,820 0.35 N/A ---------- ------ -------- Totals 22,188,320 0.35 467,500 (1) The description of the material terms of non-plan issuances of equity instruments is discussed in Notes 4, 5 and 6 to the accompanying consolidated financial statements. (2) Net of equity instruments forfeited, exercised or expired. 2000 STOCK OPTION PLAN Our 2000 Stock Option Plan (the "Plan"), adopted by us in August 2000, provides for the grant of incentive stock options (ISOs") to our full-time employees (who may also be Directors) and nonstatutory stock options ("NSOs") to non-employee Directors, consultants, customers, vendors or providers of significant services. The exercise price of any ISO may not be less than the fair market value of the Common Stock on the date of grant or, in the case of an optionee who owns more than 10% of the total combined voting power of all classes of our outstanding stock, not be less than 110% of the fair market value on the date of grant. The exercise price, in the case of any NSO, must not be less than 75% of the fair market value of the Common Stock on the date of grant. The amount reserved under the Plan is 500,000 options. At March 31, 2006, we had granted 32,500 options under the 2000 Stock Option Plan, with 467,500 available for future issuance. 2003 CONSULTANT STOCK PLAN Our 2003 Consultant Stock Plan (the "Stock Plan"), adopted by us in August 2003, advances our interests by helping us obtain and retain the services of persons providing consulting services upon whose judgment, initiative, efforts and/or services we are substantially dependent, by offering to or providing those persons with incentives or inducements affording such persons an opportunity to become owners of our capital stock. Consultants or advisors are eligible to receive grants under the plan program only if they are natural 15 persons providing bona fide consulting services to us, with the exception of any services they may render in connection with the offer and sale of our securities in a capital-raising transaction, or which may directly or indirectly promote or maintain a market for our securities. We initially reserved a total of 1,000,000 common shares for issuance under the Stock Plan and increased this to 3,000,000 on August 29, 2005. The Stock Plan provides for the grants of common stock. No awards may be issued after the ten year anniversary of the date we adopted the Stock Plan, the termination date for the plan. On March 29, 2004, we filed with the SEC a registration statement on Form S-8 for the purpose of registering 1,000,000 common shares issuable under the Stock Plan under the Securities Act of 1933. On August 29, 2005, we filed with the SEC a registration statement on Form S-8 for the purpose of registering 2,000,000 common shares issuable under The Stock Plan under the Securities Act of 1933. At March 31, 2006, 719,312 shares of common stock remain to be issued under the 2003 Consultant Stock Plan. To date we have issued 5,325,158 options (of which 1,773,300 have been exercised or cancelled) outside both the 2005 Directors Compensation Plan and 2000 Stock Option Plan. 2005 DIRECTORS COMPENSATION PROGRAM Upon the recommendation of our Compensation Committee, in February 2005, we adopted our 2005 Directors Compensation Program (the "Directors Compensation Program") which advances our interest by helping us to obtain and retain the services of outside directors upon whose judgment, initiative, efforts and/or services we are substantially dependent, by offering to or providing those persons with incentives or inducements affording them an opportunity to become owners of our capital stock. Under the Directors Compensation Program, a newly elected director will receive a one time grant of a non-qualified stock option of 1.5% of the common stock outstanding at the time of election. The options will vest one-third at the time of election to the board and the remaining two-thirds will vest equally at year end over three years. Additionally, each director will also receive an annual $25,000 non-qualified stock option retainer, $15,000 of which is to be paid at the first of the year to all directors who are on the Board prior to the first meeting of the year and a $10,000 retainer will be paid if a director attends 75% of the meetings either in person, via conference call or other electronic means. The exercise price for the options under the Directors Compensation Program will equal the average closing of the last ten (10) trading days prior to the date earned. At March 31, 2006 under the 2005 Directors Compensation Program we had issued 1,337,825 options to outside directors and 3,965,450 options to employee-directors for a total of 5,303,275 options. STAND-ALONE GRANTS From time to time our 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 our formal stock plans. The terms of these grants are individually negotiated. ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis should be read in conjunction with the consolidated Financial Statements and Notes thereto appearing elsewhere in this report. Operating Expenses Consolidated operating expenses were $2,094,939 for the fiscal year ended March 31, 2006, versus $2,183,377 for the comparable period one year ago. The net decrease of ($88,438) was comprised of an increase in Professional fees of $102,757, an increase in general and administration expense of $52,236 and an asset impairment charge of $81,722 offset by a decrease in Payroll and related expenses of ($325,063). Professional fees increased by $102,757 of which $262,239 is a result of increased scientific consulting fees associated with our human safety trials conducted in India, $56,189 in investor relations expense associated with our retention of a new Director of Corporate Communications, and $17,670 in website development costs offset by reductions of ($108,526) in director's fees and accounting expenses and ($101,074) in legal expenses. Payroll and related expenses decreased by ($325,153) of which($317,236) was due to a reduction in employee/director compensation (issuance and vesting of below-market stock options in the prior fiscal year) as well as a reduction of bonus/vacation expense of ($7,917) as compared to the prior fiscal year. 16 General and Administrative expenses increased by $52,236. This increase was comprised of increases in lab expenses of $36,920, rent expense of $20,490, utilities expense of $6,425 and depreciation expense of $6,195, offset by decreases in, in contract labor of ($18,484), decreases in lab fees of ($11,259), office supplies of ($8,821) and a net decrease in other operating expenses of ($8,152). Interest and Other Expense Other non-cash expense of $360,125 was recognized to reflect the change in fair value of the warrants issued related to our 10% Series A Convertible Notes on January 20, 2006, the date which the common shares underlying the warrants were registered under Form SB-2. Interest expense increased by $536,723 as a consequence of the increase in convertible debt required to finance the ongoing operations of the Company. This increase was comprised of $255,666 in amortization of BCF associated with convertible notes outstanding, $164,628 of interest expense on notes payable, a benefit of $113,920 recorded in the prior fiscal year due to the correction of an error and a $2,509 increase in bank service charges for the year. Other expense of $14,822 comprised of an increase of $142,245 to reflect the fair value of common stock and warrants issued to satisfy an obligation for legal expense offset by a decrease of ($131,175) for the forgiveness of debt. PLAN OF OPERATION The Company's current plan of operation is to fund our anticipated increased research and development activities and operations through the common stock purchase agreement in place with Fusion Capital, whereby Fusion Capital has committed to buy up to an additional $6,000,000 of our common stock over a 30-month period, that commenced, at our election, after the SEC declared effective a registration statement under Form SB-2 on December 7, 2004 covering such shares. Through June 15, 2006 the Company had received $1,685,001 and has $4,314,999 remaining available from this agreement. However, no assurance can be given that we will receive any additional funds under our agreement with Fusion Capital. Based on our projections of additional employees and equipment for operations and to complete research, development and testing associated with our Hemopurifier(TM) products, we anticipate that these funds will satisfy our cash requirements, including this anticipated increase in operations, in excess of the next twelve months. However, due to market conditions, and to assure availability of funding for operations in the long term, we may arrange for additional funding, subject to acceptable terms, during the next twelve months. The Company is a development stage medical device company that has not yet engaged in significant commercial activities. The primary focus of our resources is the advancement of our proprietary Hemopurifier(TM) platform treatment technology, which is designed to treat drug and vaccine resistant pathogens. The Company plans to continue its research and development activities related to the Hemopurifier(TM) platform technology, with particular emphasis on the treatment of HIV/AIDS, HCV, and acute viral conditions such as pandemic influenza and bioterror agents. The Company may choose to outsource some of its research and development in the next twelve months, as required to support our increased research and development effort that will include expanding our goal beyond treating infectious disease conditions. Accordingly, management anticipates continuing to increase spending on outsourced research and development during this period. Operations to date have consumed substantial capital without generating revenues, and will continue to require substantial and increasing capital funds to conduct necessary research and development and pre-clinical and clinical testing of our Hemopurifier(TM) products, as well as market any of those products that receive regulatory approval. The Company does not expect to generate revenue from operations for the foreseeable future, and our ability to meet our cash obligations as they become due and payable is expected to depend for at least the next several years on our ability to sell securities, borrow funds or a combination thereof. Future capital requirements will depend upon many factors, including progress with pre-clinical testing and clinical trials, the number and breadth of our clinical programs, the time and costs involved in preparing, filing, prosecuting,

maintaining and enforcing patent claims and other proprietary rights, the time and costs involved in obtaining regulatory approvals, competing technological and market developments, as well as management's ability to establish collaborative arrangements, effective commercialization, marketing activities and other arrangements. The Company expects to continue to incur increasing negative cash flows and net losses for the foreseeable future. 17 Convertible Notes Payable On March 31, 2006, the Company had $1,000,000 in 10% Series A Convertible Notes ("Promissory Notes") outstanding, offset by a ($857,635) note discount. The discount is associated with the unamortized fair value of a beneficial conversion feature and warrant attached to the Promissory Notes. The discount value will amortize to interest expense over the lives of the Promissory Notes and warrants. On March 31, 2005 the Company had no outstanding convertible notes payable. The 10% Series A Notes are described below. From July 11, 2005 through December 15, 2005 the Company received a series of cash investments totaling $760,000 from the Ellen R. Weiner Family Revocable Trust, an accredited investor, as a part of the funding of the $1.0 million Promissory Notes. The Promissory Notes accrue interest at the rate of ten percent (10%) per annum and mature on January 2, 2007. The Promissory Notes are convertible into shares of restricted common stock at any time at the election of the holder at a conversion price equal to $0.20 per share for any conversion occurring on or prior to the maturity date. In addition, upon conversion, the Company is obligated to issue a three-year Warrant to purchase a number of shares equal to the number of shares into which the Note was converted at an exercise price of $0.20. From August 2, 2005 through December 15, 2005 the Company received cash investments totaling $225,000 from Allan S. Bird, an accredited investor, as a part of the funding of the $1.0 Promissory Notes. The Promissory Notes accrue interest at the rate of ten percent (10%) per annum and mature on January 2, 2007. The Promissory Notes are convertible into shares of restricted common stock at any time at the election of the holder at a conversion price equal to $0.20 per share for any conversion occurring on or prior to the maturity date. In addition, upon conversion, the Company is obligated to issue a three-year Warrant to purchase a number of shares equal to the number of shares into which the Note was converted at an exercise price of $0.20. On December 15, 2005 the Company received cash investments totaling $10,000 from Christian J. Hoffmann III and $5,000 from Claypoole Capital LLC (an affiliate of Mr. Hoffmann), accredited investors, as a part of the funding of the $1.0 million Promissory Notes. The Promissory Notes accrue interest at the rate of ten percent (10%) per annum and mature on January 2, 2007. The Promissory Notes are convertible into shares of restricted common stock at any time at the election of the holder at a conversion price equal to $0.20 per share for any conversion occurring on or prior to the maturity date. In addition, upon conversion, the Company is obligated to issue a three-year Warrant to purchase a number of shares equal to the number of shares into which the Note was converted at an exercise price of $0.20. Mr. Hoffmann is legal counsel to the Ellen R. Weiner Family Revocable Trust. On May 16, 2005 the Company issued Fusion Capital ("Fusion") a $30,000 Convertible Promissory Note (the "Convertible Note") with an interest rate of fifteen percent (15%) per annum that matures on August 15, 2005 (the "Maturity Date"). The NOte converted into 176,716 restricted common shares at a conversion rate of $0.20 per share in March 2006. Notes Payable At March 31, 2006, the Company had $527,500 in principal amount of notes payable outstanding with 14 noteholders as compared with $537,500 outstanding at March 31, 2005 with 16 noteholders. On May 27, 2005, the Company issued a promissory note (the "Note") to an accredited investor in an amount of $100,000 with 12% interest maturing on December 1, 2005. In conjunction with the issuance of the Note, the Company also issued a 12-month warrant to acquire 400,000 shares of Common Stock at $0.25 per share. On October 3, 2005, the Company retired a 10% Note Payable in an amount of $40,000 for cash. On October 10, 2005, the Company retired a 10% Note Payable in an amount of $40,000 for cash. On March 23, 2006, the Company retired a 10% Debenture Note in an amount of $30,000 plus accrued interest $4,564 in exchange for 140,000 restricted shares of common stock. 18 The Company is currently in default on approximately $527,500 of amounts owed under various unsecured notes payable and accrued liabilities and is currently seeking other financing arrangements to retire all past due notes. At March 31, 2006 the Company had accrued interest in the amount of $286,098 associated with these notes payable. Securities Issued for Services We have issued securities in payment of services to reduce our obligations and to avoid using our cash resources. In the year ended March 31, 2006 we issued 2,737,588 common shares for services of which 1,030,700 were unregistered. We issued 579,813 restricted common shares in settlement of a legal dispute, 150,000 restricted common shares for financial consulting services, 116,883 restricted common shares for corporate communications services, 110,040 restricted common shares for accrued legal fees and 73,964 restricted common shares for legal fees related to financing activities. In addition, 1,706,888 shares, registered under a Form S-8 registration statement, were issued as follows: 1,061,129 for scientific and regulatory consulting, 399,131 for legal

expense, 110,040 for payment of accrued legal fees, 103,255 for financial consulting and 33,333 for the right to license intellectual property assets. The average price discount of common shares issued for these services, weighted by The number of shares issued for services in this period, was approximately 9%. For the fiscal year ended March 31, 2005 we issued 1,412,625 common shares for services, of which 854,978 of the shares issued were unregistered. We issued 468,604 restricted common shares for commitment and financing fees associated with the $6 million commitment from Fusion Capital; 225,000 restricted common shares for payment of legal services associated with the related private placement and Form SB-2 registration statement, 10,715 restricted common shares for employment placement fees; 143,809 restricted common shares were issued for investor relations and 6,850 restricted common shares were issued for technical consulting. In addition, 557,647 shares, registered under a Form S-8 registration statement, were issued as follows: for corporate and SEC legal advice, 356,547 shares; for regulatory and technical consulting, 132,236 shares; for employment placement fee, 46,364 shares and for achievement of employee goals and objectives, 22,500 shares. The value of services purchased with registered and restricted shares was approximately $337,000. The average price discount of common stock issued for these services, weighted by the number of shares issued for services in this period, was approximately 36%. Securities Issued for Debt We have also issued securities for debt to reduce our obligations to avoid using our cash resources. In the fiscal year ended March 31, 2006 we issued 314,716 restricted common shares for repayment in full of notes, including accrued interest. The price discount of the common stock issued for debt in this period weighted by the number of shares issued for conversion of debt was approximately 70%, primarily to reflect the fact that these common shares were not freely tradeable when issued. In the fiscal year ended March 31, 2005 we issued 847,755 common shares for repayment in full of notes, including accrued interest. The price discount of common stock issued for debt in this period, weighted by number of shares issued for conversion of debt in this period, was approximately 41%, partially due to a substantial discount in the conversion of the $125,000 convertible note in accordance with its original terms in 2001. Prospects for Debt Conversion We seek, where possible, to convert our debt and accounts payable to stock and/or warrants in order to reduce our cash liabilities. Our success at accomplishing this depends on several factors including market conditions, investor acceptance and other factors, including our business prospects. GOING CONCERN Our independent registered public accounting firm has stated in their audit report on our March 31, 2006 consolidated financial statements, that we have a working capital deficiency and a significant deficiency accumulated during the development stage. These conditions, among others, raise substantial doubt about our ability to continue as a going concern. 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, 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. 19 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, 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. 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 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 noted certain impairment indicators requiring review for impairment during the year ended March 31, 2006 and recorded an impairment loss on patents totaling $81,722. Stock Purchase Warrants Issued with Notes Payable The Company granted warrants in connection with the issuance of certain notes payable. Under Accounting Principles Board Opinion No. 14, "Accounting for Convertible Debt and Debt Issued With Stock Purchase Warrants," the relative estimated fair value of such warrants represents a discount from the face amount of the notes payable. Such discounts are amortized to interest expense over the term of the notes. Derivatives The Company was obligated to register for resale the shares underlying warrants in connection with the issuance of its 10% Series A Convertible Promissory Notes. In accordance with Emerging Issues Task Force ("EITF") No. 00-19, "Accounting for Derivative Financial Instruments Indexed To, and Potentially Settled In, a Company's Own Stock," the value of the warrants were recorded as a liability until the registration became effective on January 20, 2006. At that time the Company determined the fair value of these warrants and recorded an additional non-cash expense of $363,875. Coincident with this valuation, the derivative liability balance was reclassified to equity. Beneficial Conversion Feature of 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 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. Accounting for Transactions involving Stock Compensation Financial Accounting Standards Board ("FASB") Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB 25" clarifies the application of APB 25 for (a) the definition of employee for purposes of applying APB 25, (b) the criteria for determining whether a plan qualifies as a non-compensatory plan, (c) the accounting consequence for various modifications to the terms of a previously fixed stock option or award, and (d) the accounting for an exchange of stock compensation awards in a business combination. Under APB 25 compensation expense is the excess, if any, of the estimated fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period. 20 SFAS 123, if fully adopted, changes the method of accounting for employee stock-based compensation plans to the fair value based method. For stock options and warrants, fair value is estimated using an option pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option or warrant, stock volatility and the annual rate of quarterly dividends. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period. The adoption of the accounting methodology of SFAS 123 is optional and we have elected to continue accounting for stock-based compensation issued to employees using APB 25; however, pro forma disclosures, as we adopted the cost recognition requirement under SFAS 123, are required to be presented. SFAS 148, "Accounting for Stock-based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123," provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. In December 2004, the FASB issued SFAS No. 123-R, "Share-Based Payment," which requires that the compensation cost relating to share-based payment transactions (including the cost of all employee stock options) be recognized in the financial statements. That cost will be measured based on the estimated fair value of the equity or liability instruments issued. SFAS No. 123-R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS No.123-R replaces SFAS No. 123 and supersedes APB 25. As originally issued, SFAS No. 123 established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that pronouncement permitted entities to continue applying the intrinsic-value model of APB 25, provided that the financial statements disclosed the pro forma net income or loss based on the preferable fair-value method. Small Business Issuers are required to apply SFAS No. 123-R in the first interim or annual reporting period of the registrant's first fiscal year that begins after December 15, 2005. Thus, the Company's consolidated financial

statements will reflect an expense for (a) all share-based compensation arrangements granted on or after January 1, 2006 and for any such arrangements that are modified, cancelled, or repurchased on or after that date, and (b) the portion of previous share-based awards for which the requisite service has not been rendered as of that date, based on the grant-date estimated fair value. Management has not yet determined the future effect of FAS 123-R on its consolidated financial statements. OFF-BALANCE SHEET ARRANGEMENTS We have not entered into any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources and would be considered material to investors. RISK FACTORS An investment in our common shares involves a high degree of risk and is subject to many uncertainties. These risks and uncertainties may adversely affect our business, operating results and financial condition. In such an event, the trading price for our common shares could decline substantially, and you could lose all or part of your investment. In order to attain an appreciation for these risks and uncertainties, you should read this annual report in its entirety and consider all of the information and advisements contained in this annual report, including the following risk factors and uncertainties. RISKS RELATING TO OUR BUSINESS WE HAVE A LIMITED OPERATING HISTORY WITH SIGNIFICANT LOSSES AND EXPECT LOSSES TO CONTINUE FOR THE FORESEEABLE FUTURE. We have yet to establish any history of profitable operations. We have not had any revenues for the past three years. We have incurred annual operating losses of $2,094,939, $2,183,377 and $995,549 respectively, during the past three fiscal years of operation. We have incurred net losses from continuing operations of $2,920,183 and $2,096,951 for the fiscal years ending March 31, 2006 and 2005. As a result, at March 31, 2006, we had an accumulated deficit of $22,062,447. Our revenues have not been sufficient to sustain our operations. We expect that our revenues will not be sufficient to sustain our operations for the foreseeable future. Our profitability will require the successful commercialization of our Hemopurifier(TM) technology. No assurances can be given when or if this will occur or that we will ever be profitable. 21 WE HAVE RECEIVED AN OPINION FROM OUR AUDITORS REGARDING OUR ABILITY TO CONTINUE AS A GOING CONCERN Our independent auditors noted in their report accompanying our financial statements for our fiscal year ended March 31, 2006 that we had a significant deficit accumulated during the development stage, had a working capital deficit and that a significant amount of additional capital, approximately $5,000,000 as estimated by management, will be necessary to advance the development of our products to the point at which we may become commercially viable and stated that those conditions raised substantial doubt about our ability to continue as a going concern. Note 1 to our financial statements addressed management's plans to address these matters. We cannot assure you that our business plans will be successful in addressing these issues. This opinion about our ability to continue as a going concern could affect our ability to obtain additional financing at favorable terms, if at all, as such an opinion may cause investors to lose faith in our long term prospects. If we cannot successfully continue as a going concern, our shareholders may lose their entire investment in our common shares. WE WILL REQUIRE ADDITIONAL FINANCING TO SUSTAIN OUR OPERATIONS AND WITHOUT IT WE WILL NOT BE ABLE TO CONTINUE OPERATIONS. At March 31, 2006 and 2005, we had a working capital deficit of approximately $1,920,000 and $3,349,000, respectively. The independent auditors' report for the year ended March 31, 2006, includes an explanatory paragraph stating that, among other conditions, our recurring losses from operations and working capital deficiency raise substantial doubt about our ability to continue as a going concern. We had a net operating cash flow deficit of $1,584,281 for the fiscal year ended March 31, 2006, a net operating cash flow deficit of $1,559,366 for the year ended March 31, 2005, and for the year ended March 31, 2004 a net operating cash flow deficit of $542,056. We do not currently have sufficient financial resources to fund our operations or those of our subsidiaries. Therefore, we need additional funds to continue these operations. We have the right to receive $10,000 per trading day under an agreement with Fusion Capital Fund II, LLC unless our stock price equals or exceeds $1.00, in which case the daily amount may be increased under certain conditions as the price of our common stock increases. The extent to which we rely on Fusion Capital as a source of funding will depend on a number of factors including, the prevailing market price of our common stock and the extent to which we are able to secure working capital from other sources, such as through the commercialization or licensing of our Hemopurifier(TM) technology. If obtaining sufficient financing from Fusion Capital were to prove prohibitively expensive and if we are unable to commercialize and sell our Hemopurifier(TM) technology, we will need to secure another source of funding in order to satisfy our working capital needs. Should the financing we require to sustain our working capital needs be unavailable or prohibitively expensive when we require it, the consequences would be a material adverse effect on our business,

operating results, financial condition and prospects. WE MAY FAIL TO OBTAIN GOVERNMENT CONTRACTS TO DEVELOP OUR HEMOPURIFIER(TM) TECHNOLOGY FOR BIODEFENSE APPLICATIONS. The U.S. Government has undertaken commitments to help secure improved countermeasures against bioterrorism. To date, we have submitted four Small Business Innovative Research ("SBIR") grant proposals, one in 2002, one in April 2004, and two in May 2006 with the National Institutes of Health that relate to the use of our Hemopurifier(TM) as a treatment countermeasure against certain biological weapon candidates and we anticipate that we will submit additional proposals to obtain U.S. Government grants. The first proposal in 2002 was reviewed but not scored. We expanded the proposal, submitted the proposal in 2004 and it was again reviewed but not scored as the term countermeasures in SBIR and other related Request for Proposal ("RFP") grants includes drugs and vaccines, but not medical devices such as the Hemopurifier(TM). Presently, the two most recent grant submissions are in process. As a result, future attempts to obtain grant income from the Federal Government will be sought through direct communication to government health and military agencies, and may include unsolicited proposals to provide the Hemopurifier(TM) as a treatment countermeasure. At present, the Hemopurifier(TM) has not been approved for use by any government agency, nor have we received any contracts to purchase the Hemopurifier(TM). Since inception, we have not generated revenues from the sale of any product based on our Hemopurifier(TM) technology platform. The process of obtaining government contracts is lengthy with the uncertainty that we will be successful in obtaining announced grants or contracts for therapeutics as a medical device technology. Accordingly, we cannot be certain that we will be awarded any future government grants or contracts utilizing our Hemopurifier(TM) platform technology. 22 IF THE U.S. GOVERNMENT FAILS TO PURCHASE SUFFICIENT QUANTITIES OF ANY FUTURE BIODEFENSE CANDIDATE UTILIZING OUR HEMOPURIFIER(TM) PLATFORM TECHNOLOGY, WE MAY BE UNABLE TO GENERATE SUFFICIENT REVENUES TO CONTINUE OPERATIONS. We cannot be certain of the timing or availability of any future funding from the U.S. Government, and substantial delays or cancellations of funding could result from protests or challenges from third parties once such funding is obtained. If we develop products utilizing our Hemopurifier(TM) platform technology that are approved by the U.S. Food and Drug Administration (the "FDA"), but the U.S. Government does not place sufficient orders for these products, our future business will be harmed. U.S. GOVERNMENT AGENCIES HAVE SPECIAL CONTRACTING REQUIREMENTS, WHICH CREATE ADDITIONAL RISKS. Our plan to provide the Hemopurifier(TM) as a candidate to treat Certain infectious disease conditions may involve contracts with the U.S. Government. U.S. Government contracts typically contain unfavorable termination provisions and are subject to audit and modification by the government at its sole discretion, which subjects us to additional risks. These risks include the ability of the U.S. Government to unilaterally: o suspend or prevent us for a period of time from receiving new contracts or extending existing contracts based on violations or suspected violations of laws or regulations; o audit and object to our contract-related costs and fees, including allocated indirect costs; o control and potentially prohibit the export of our products; and o change certain terms and conditions in our contracts. If we were to become a U.S. Government contractor, we would be required to comply with applicable laws, regulations and standards relating to our accounting practices and would be subject to periodic audits and reviews. As part of any such audit or review, the U.S. Government may review the adequacy of, and our compliance with, our internal control systems and policies, including those relating to our purchasing, property, estimating, compensation and management information systems. Based on the results of its audits, the U.S. Government may adjust our contract-related costs and fees, including allocated indirect costs. In addition, if an audit or review uncovers any improper or illegal activity, we would possibly be subject to civil and criminal penalties and administrative sanctions, including termination of our contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. Government. We could also suffer serious harm to our reputation if allegations of impropriety were made against us. Although adjustments arising from government audits and reviews have not seriously harmed our business in the past, future audits and reviews could cause adverse effects. In addition, under U.S. Government purchasing regulations, some of our costs, including most financing costs, amortization of intangible assets, portions of our research and development costs, and some marketing expenses, would possibly not be reimbursable or allowed under such contracts. Further, as a U.S. Government contractor, we would be subject to an increased risk of investigations, criminal prosecution, civil fraud, whistleblower lawsuits and other legal actions and liabilities to which purely private sector companies are not. WE WILL FACE INTENSE COMPETITION FROM COMPANIES THAT HAVE GREATER FINANCIAL, PERSONNEL AND RESEARCH AND DEVELOPMENT RESOURCES THAN OURS. THESE COMPETITIVE FORCES MAY IMPACT OUR

PROJECTED GROWTH AND ABILITY TO GENERATE REVENUES AND PROFITS, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND THE VALUE OF YOUR INVESTMENT. Our competitors are developing vaccine candidates, which could compete with the Hemopurifier(TM) medical device candidates we are developing. Our commercial opportunities will be reduced or eliminated if our competitors develop and market products for any of the diseases we target that: o are more effective; o have fewer or less severe adverse side effects; o are better tolerated; o are more adaptable to various modes of dosing; o are easier to administer; or o are less expensive than the products or product candidates we are developing. 23 Even if we are successful in developing effective Hemopurifier(TM) products, and obtain FDA and other regulatory approvals necessary for commercializing them, our products may not compete effectively with other successful products. Researchers are continually learning more about diseases, which may lead to new technologies for treatment. Our competitors may succeed in developing and marketing products that are either more effective than those that we may develop, alone or with our collaborators, or that are marketed before any products we develop are marketed. The Congress' recent passage of the Project BioShield Bill, a comprehensive effort to develop and make available modern, effective drugs and vaccines to protect against attack by biological and chemical weapons or other dangerous pathogens, may encourage competitors to develop their own product candidates. We cannot predict the decisions that will be made in the future by the various government agencies as a result of such legislation. Our competitors include fully integrated pharmaceutical companies and biotechnology companies as well as universities and public and private research institutions. Many of the organizations competing with us, have substantially greater capital resources, larger research and development staffs and facilities, greater experience in product development and in obtaining regulatory approvals, and greater marketing capabilities than we do. The market for medical devices is intensely competitive. Many of our potential competitors have longer operating histories, greater name recognition, more employees, and significantly greater financial, technical, marketing, public relations, and distribution resources than we have. This intense competitive environment may require us to make changes in our products, pricing, licensing, services or marketing to develop, maintain and extend our current technology. Price concessions or the emergence of other pricing or distribution strategies of competitors may diminish our revenues (if any), adversely impact our margins or lead to a reduction in our market share (if any), any of which may harm our business. WE HAVE LIMITED MANUFACTURING EXPERIENCE. To achieve the levels of production necessary to commercialize our Hemopurifier(TM) products, we will need secure manufacturing agreements with manufacturers which comply with good manufacturing practices standards and other standards prescribed by various federal, state and local regulatory agencies in the U.S. and any other country of use. We have limited experience manufacturing products for testing purposes and no experience manufacturing products for large scale commercial purposes. We will likely outsource the manufacture of our Hemopurifier(TM) products to third parties operating FDA-certified facilities. To date, we have manufactured devices on a small scale for testing purposes. There can be no assurance that manufacturing and control problems will not arise as we attempt to commercialize our products or that such manufacturing can be completed in a timely manner or at a commercially reasonable cost. Any failure to surmount such problems could delay or prevent commercialization of our products and would have a material adverse effect on us. OUR HEMOPURIFER(TM) TECHNOLOGY MAY BECOME OBSOLETE. Our Hemopurifier(TM) products may be made unmarketable by new scientific or technological developments where new treatment modalities are introduced that are more efficacious and/or more economical than our Hemopurifier(TM) products. The Homeland Security industry is growing rapidly with many competitors trying to develop products or vaccines to protect against infectious disease. Any one of our competitors could develop a more effective product which would render our technology obsolete. OUR USE OF HAZARDOUS MATERIALS, CHEMICALS AND VIRUSES REQUIRE US TO COMPLY WITH REGULATORY REQUIREMENTS AND EXPOSES US TO POTENTIAL LIABILITIES. Our research and development involves the controlled use of hazardous materials, chemicals and viruses. The primary hazardous materials include chemicals needed to construct the Hemopurifier(TM) cartridges and HIV and Hepatitis C infected plasma samples used in preclinical testing of the Hemopurifier(TM). All other chemicals are fully inventoried and reported to the appropriate authorities, such as the fire department, who inspect the facility on a regular basis. We are subject to federal, state, local and foreign laws governing the use, manufacture, storage, handling and disposal of such materials. Although we believe that our safety procedures for the use, manufacture, storage, handling and disposal of such materials comply with the standards prescribed by federal, state, local and foreign regulations, we cannot completely eliminate the risk of accidental contamination or injury from these materials. We have had no incidents or problems involving hazardous

chemicals or biological samples. In the event of such an accident, we could be held liable for significant damages or fines. We currently carry a limited amount of insurance to protect us from these damages. In addition, we may be required to incur significant costs to comply with regulatory requirements in the future. 24 WE ARE DEPENDENT FOR OUR SUCCESS ON A FEW KEY EXECUTIVE OFFICERS. OUR INABILITY TO RETAIN THOSE OFFICERS WOULD IMPEDE OUR BUSINESS PLAN AND GROWTH STRATEGIES, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND THE VALUE OF YOUR INVESTMENT. Our success depends to a critical extent on the continued services of Our Chairman and Chief Executive Officer, James A. Joyce and our Chief Science Officer, Richard H. Tullis. Were we to lose one or more of these key executive officers, we would be forced to expend significant time and money in the pursuit of a replacement, which would result in both a delay in the implementation of our business plan and the diversion of limited working capital. The loss of Dr. Tullis could delay the clinical development of our products due to his unique experience with the Hemopurifier(TM) technology. The loss of Mr. Joyce would be detrimental to our growth as he possesses unique knowledge of our business model and infectious disease which would be difficult to replace. We can give you no assurance that we can find satisfactory replacements for these key executive officers at all, or on terms that are not unduly expensive or burdensome to our company. Although Mr. Joyce and Mr. Tullis have signed employment agreements providing for their continued service to our company, these agreements will not preclude them from leaving our company. We do not currently carry key man life insurance policies on any of our key executive officers which would assist us in recouping our costs in the event of the loss of those officers. OUR INABILITY TO ATTRACT AND RETAIN QUALIFIED PERSONNEL COULD IMPEDE OUR ABILITY TO GENERATE REVENUES AND PROFITS AND TO OTHERWISE IMPLEMENT OUR BUSINESS PLAN AND GROWTH STRATEGIES, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND COULD ADVERSELY AFFECT THE VALUE OF YOUR INVESTMENT. We currently have an extremely small staff comprised of five full time employees consisting of our Chief Executive Officer, our Chief Science Officer, our Chief Financial Officer, a research scientist, a research associate, as well as other personnel employed on a contract basis. Although we believe that these employees, together with the consultants currently engaged by our company, will be able to handle most of our additional administrative, research and development and business development in the near term, we will nevertheless be required over the longer-term to hire highly skilled managerial, scientific and administrative personnel to fully implement our business plan and growth strategies. Due to the specialized scientific nature of our business, we are highly dependent upon our ability to attract and retain qualified scientific, technical and managerial personal. Competition for these individuals, especially in San Diego where many bio-technology companies are located, is intense and we may not be able to attract, assimilate or retain additional highly qualified personnel in the future. We cannot assure you that we will be able to engage the services of such qualified personnel at competitive prices or at all, particularly given the risks of employment attributable to our limited financial resources and lack of an established track record. WE PLAN TO GROW VERY RAPIDLY, WHICH WILL PLACE STRAINS ON OUR MANAGEMENT TEAM AND OTHER COMPANY RESOURCES TO BOTH IMPLEMENT MORE SOPHISTICATED MANAGERIAL, OPERATIONAL AND FINANCIAL SYSTEMS, PROCEDURES AND CONTROLS AND TO TRAIN AND MANAGE THE PERSONNEL NECESSARY TO IMPLEMENT THOSE FUNCTIONS. OUR INABILITY TO MANAGE OUR GROWTH COULD IMPEDE OUR ABILITY TO GENERATE REVENUES AND PROFITS AND TO OTHERWISE IMPLEMENT OUR BUSINESS PLAN AND GROWTH STRATEGIES, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND THE VALUE OF YOUR INVESTMENT. We will need to significantly expand our operations to implement our longer-term business plan and growth strategies. We will also be required to manage multiple relationships with various strategic partners, technology licensors, customers, manufacturers and suppliers, consultants and other third parties. This expansion and these expanded relationships will require us to significantly improve or replace our existing managerial, operational and financial systems, procedures and controls; to improve the coordination between our various corporate functions; and to manage, train, motivate and maintain a growing employee base. The time and costs to effectuate these steps may place a significant strain on our management personnel, systems and resources, particularly given the limited amount of financial resources and skilled employees that may be available at the time. We cannot assure you that we will institute, in a timely manner or at all, the improvements to our managerial, operational and financial systems, procedures and controls necessary to support our anticipated increased levels of operations and to coordinate our various corporate functions, or that we will be able to properly manage, train, motivate and retain our anticipated increased employee base. WE MAY HAVE

DIFFICULTY IN ATTRACTING AND RETAINING MANAGEMENT AND OUTSIDE INDEPENDENT MEMBERS TO OUR BOARD OF DIRECTORS AS A RESULT OF THEIR CONCERNS RELATING TO THEIR INCREASED PERSONAL EXPOSURE TO LAWSUITS AND SHAREHOLDER CLAIMS BY VIRTUE OF HOLDING THESE POSITIONS IN A PUBLICLY-HELD COMPANY 25 The directors and management of publicly traded corporations are increasingly concerned with the extent of their personal exposure to lawsuits and shareholder claims, as well as governmental and creditor claims which may be made against them, particularly in view of recent changes in securities laws imposing additional duties, obligations and liabilities on management and directors. Due to these perceived risks, directors and management are also becoming increasingly concerned with the availability of directors and officers liability insurance to pay on a timely basis the costs incurred in defending such claims. We currently do carry limited directors and officers liability insurance. Directors and officers liability insurance has recently become much more expensive and difficult to obtain. If we are unable to continue or provide directors and officers liability insurance at affordable rates or at all, it may become increasingly more difficult to attract and retain qualified outside directors to serve on our board of directors. We may lose potential independent board members and management candidates to other companies in the biotechnology field that have greater directors and officers liability insurance to insure them from liability or to biotechnology companies that have revenues or have received greater funding to date which can offer greater compensation packages. The fees of directors are also rising in response to their increased duties, obligations and liabilities as well as increased exposure to such risks. As a company with a limited operating history and limited resources, we will have a more difficult time attracting and retaining management and outside independent directors than a more established company due to these enhanced duties, obligations and liabilities. IF WE FAIL TO COMPLY WITH EXTENSIVE REGULATIONS OF DOMESTIC AND FOREIGN REGULATORY AUTHORITIES, THE COMMERCIALIZATION OF OUR PRODUCT CANDIDATES COULD BE PREVENTED OR DELAYED. The Hemopurifier (TM) is subject to extensive government regulations related to development, testing, manufacturing and commercialization in the United States and other countries. The determination of when and whether a product is ready for large scale purchase and potential use will be made by the government through consultation with a number of governmental agencies, including the FDA, the National Institutes of Health, the Centers for Disease Control and Prevention and the Department of Homeland Security. Our product candidates are in the pre-clinical and clinical stages of development and have not received required regulatory approval from the FDA to be commercially marketed and sold. The process of obtaining and complying with FDA and other governmental regulatory approvals and regulations is costly, time consuming, uncertain and subject to unanticipated delays. Such regulatory approval (if any) and product development requires several years. Despite the time and expense exerted, regulatory approval is never guaranteed. We also are subject to the following risks and obligations, among others. o The FDA may refuse to approve an application if they believe that applicable regulatory criteria are not satisfied. o The FDA may require additional testing for safety and effectiveness. o The FDA may interpret data from pre-clinical testing and clinical trials in different ways than we interpret them. o If regulatory approval of a product is granted, the approval may be limited to specific indications or limited with respect to its distribution. o The FDA may change their approval policies and/or adopt new regulations. Failure to comply with these or other regulatory requirements of the FDA may subject us to administrative or judicially imposed sanctions, including: o warning letters; o civil penalties; o criminal penalties; o injunctions; o product seizure or detention; o product recalls; and o total or partial suspension of productions. DELAYS IN SUCCESSFULLY COMPLETING OUR CLINICAL TRIALS COULD JEOPARDIZE OUR ABILITY TO OBTAIN REGULATORY APPROVAL OR MARKET OUR HEMOPURIFIER(TM) PRODUCT CANDIDATES ON A TIMELY BASIS. 26 Our business prospects will depend on our ability to complete clinical trials, obtain satisfactory results, obtain required regulatory approvals and successfully commercialize our Hemopurifier(TM) product candidates. Completion of our clinical trials, announcement of results of the trials and our ability to obtain regulatory approvals could be delayed for a variety of reasons, including: o serious adverse events related to our medical device candidates; o unsatisfactory results of any clinical trial; o the failure of our principal third-party investigators to perform our clinical trials on our anticipated schedules; and/or o different interpretations of our pre-clinical and clinical data, which could initially lead to inconclusive results. Our development costs will increase if we have material delays in any clinical trial or if we need to perform more or larger clinical trials than planned. If the delays are significant, or if any of our Hemopurifier(TM) product candidates do not prove to be safe or effective or do not receive required regulatory approvals, our financial results and the commercial prospects for our product candidates will be harmed. Furthermore,

our inability to complete our clinical trials in a timely manner could jeopardize our ability to obtain regulatory approval. THE INDEPENDENT CLINICAL INVESTIGATORS THAT WE RELY UPON TO CONDUCT OUR CLINICAL TRIALS MAY NOT BE DILIGENT, CAREFUL OR TIMELY, AND MAY MAKE MISTAKES, IN THE CONDUCT OF OUR CLINICAL TRIALS. We depend on independent clinical investigators to conduct our clinical trials. The investigators are not our employees, and we cannot control the amount or timing of resources that they devote to our product development programs. If independent investigators fail to devote sufficient time and resources to our product development programs, or if their performance is substandard, it may delay FDA approval of our medical device candidates. These independent investigators may also have relationships with other commercial entities, some of which may compete with us. If these independent investigators assist our competitors at our expense, it could harm our competitive position. THE APPROVAL REQUIREMENTS FOR MEDICAL PRODUCTS USED TO FIGHT BIOTERRORISM ARE STILL EVOLVING, AND WE CANNOT BE CERTAIN THAT ANY PRODUCTS WE DEVELOP, IF EFFECTIVE, WOULD MEET THESE REQUIREMENTS. We are developing product candidates based upon current governmental policies regulating these medical countermeasure treatments. For instance, we intend to pursue FDA approval of our proprietary pathogen filtration devices to treat infectious agents under requirements published by the FDA that allow the FDA to approve certain medical devices used to reduce or prevent the toxicity of chemical, biological, radiological or nuclear substances based on human clinical data to demonstrate safety and immune response, and evidence of effectiveness derived from appropriate animal studies and any additional supporting data. Our business is subject to substantial risk because these policies may change suddenly and unpredictably and in ways that could impair our ability to obtain regulatory approval of these products, and we cannot guarantee that the FDA will approve our proprietary pathogen filtration devices. OUR PRODUCT DEVELOPMENT EFFORTS MAY NOT YIELD MARKETABLE PRODUCTS DUE TO RESULTS OF STUDIES OR TRIALS, FAILURE TO ACHIEVE REGULATORY APPROVALS OR MARKET ACCEPTANCE, PROPRIETARY RIGHTS OF OTHERS OR MANUFACTURING ISSUES. Our success depends on our ability to successfully develop and obtain regulatory approval to market new filtration devices. We expect that a significant portion of the research that we will conduct will involve new and unproven technologies. Development of a product requires substantial technical, financial and human resources even if the product is not successfully completed. Our previously planned products have not become marketable products due in part to our transition in 2001 from a focus on utilizing our Hemopurifier(TM) technology on treating harmful metals to treating infectious diseases prior to our having completed the FDA approval process. Our transition was made in order to focus on larger markets with an urgent need for new treatment and to take advantage of the sense of greater sense of urgency surrounding acute and chronic infectious diseases. Prior to initiating the development of infectious disease Hemopurifiers(TM), we successfully completed an FDA approved Phase I human safety trial of a Hemopurifier(TM) to treat aluminum and iron intoxication. Since changing the focus to infectious disease research, we have not initiated an FDA approved human clinical trial as the development of the technology is still continuing and will require both significant capital and scientific resources. Our pending products face similar challenges of obtaining successful clinical trials in route to gaining FDA approval prior to commercialization. Additionally, our limited financial resources hinder the speed of our product development due to personal constraints. 27 Our potential products may appear to be promising at various stages of development yet fail to reach the market for a number of reasons, including the: o lack of adequate quality or sufficient prevention benefit, or unacceptable safety during pre-clinical studies or clinical trials; o failure to receive necessary regulatory approvals; o existence of proprietary rights of third parties; and/or o inability to develop manufacturing methods that are efficient, cost-effective and capable of meeting stringent regulatory standards. POLITICAL OR SOCIAL FACTORS MAY DELAY OR IMPAIR OUR ABILITY TO MARKET OUR PRODUCTS. Products developed to treat diseases caused by or to combat the threat of bioterrorism will be subject to changing political and social environments. The political and social responses to bioterrorism have been highly charged and unpredictable. Political or social pressures may delay or cause resistance to bringing our products to market or limit pricing of our products, which would harm our business. Bioterrorism has become the focus of political debates especially with the upcoming presidential elections, both in terms of how to approach bioterrorism and the amount funding the government should provide for any programs involving homeland protection. Government funding for products on bioterrorism could be reduced which would hinder our ability to obtain governmental grants. OUR INABILITY TO PROTECT OUR INTELLECTUAL PROPERTY RIGHTS COULD NEGATIVELY IMPACT OUR PROJECTED GROWTH AND ABILITY TO GENERATE REVENUES AND PROFITS, WHICH WOULD

HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND THE VALUE OF YOUR INVESTMENT. We rely on a combination of patents, patents pending, copyrights, trademark and trade secret laws, proprietary rights agreements and non-disclosure agreements to protect our intellectual properties. We cannot give you any assurance that these measures will prove to be effective in protecting our intellectual properties. In the case of patents, we cannot give you any assurance that our existing patents will not be invalidated, that any patents that we currently or prospectively apply for will be granted, or that any of these patents will ultimately provide significant commercial benefits. Further, competing companies may circumvent any patents that we may hold by developing products which closely emulate but do not infringe our patents. While we intend to seek patent protection for our products in selected foreign countries, those patents may not receive the same degree of protection as they would in the United States. We can give you no assurance that we will be able to successfully defend our patents and proprietary rights in any action we may file for patent infringement. Similarly, we cannot give you any assurance that we will not be required to defend against litigation involving the patents or proprietary rights of others, or that we will be able to obtain licenses for these rights. Legal and accounting costs relating to prosecuting or defending patent infringement litigation may be substantial. Since many of our patents were issued in the 1980's, they may expire before FDA approval, if any, is obtained. One of our patents, (Ambrus and Horvath - Blood Purification) expires in October 2007. However, we believe that certain patent applications filed and/or other patents issued more recently will help to protect the proprietary nature of the Hemopurifier(TM) treatment technology. The Hemopurifier(TM) is protected by four issued patents, in the United States, Europe and Japan, three of which we own and one in which we own an exclusive license. One additional US patent application deals with treatments for virus infection and manufacturing methods has been accepted by the European Patent Office and is in process of being translated and filed in the United Kingdom, Germany, France and Italy. We also rely on proprietary designs, technologies, processes and know-how not eligible for patent protection. We cannot give you any assurance that our competitors will not independently develop the same or superior designs, technologies, processes and know-how. While we have and will continue to enter into proprietary rights agreements with our employees and third parties giving us proprietary rights to certain technology developed by those employees or parties while engaged by our company, we can give you no assurance that courts of competent jurisdiction will enforce those agreements. LEGISLATIVE ACTIONS AND POTENTIAL NEW ACCOUNTING PRONOUNCEMENTS ARE LIKELY TO IMPACT OUR FUTURE FINANCIAL POSITION AND RESULTS OF OPERATIONS. 28 There have been regulatory changes, including the Sarbanes-Oxley Act of 2002, and there may potentially be new accounting pronouncements or additional regulatory rulings which will have an impact on our future financial position and results of operations. The Sarbanes-Oxley Act of 2002 and other rule changes as well as proposed legislative initiatives following the Enron bankruptcy have increased our general and administrative costs as we have incurred increased legal and accounting fees to comply with such rule changes. Further, proposed initiatives are expected to result in changes in certain accounting rules, including legislative and other proposals to account for employee stock options as a compensation expense. These and other potential changes could materially increase the expenses we report under accounting principles generally accepted in the United States of America, and adversely affect our operating results. OUR PRODUCTS MAY BE SUBJECT TO RECALL OR PRODUCT LIABILITY CLAIMS. Our Hemopurifier(TM) products may be used in connection with medical procedures in which it is important that those products function with precision and accuracy. If our products do not function as designed, or are designed improperly, we may be forced by regulatory agencies to withdraw such products from the market. In addition, if medical personnel or their patients suffer injury as a result of any failure of our products to function as designed, or our products are designed inappropriately, we may be subject to lawsuits seeking significant compensatory and punitive damages. The risk of product liability claims, product recalls and associated adverse publicity is inherent in the testing, manufacturing, marketing and sale of medical products. We do not have general clinical trial liability insurance coverage. There can be no assurance that future insurance coverage will to be adequate or available. We may not be able to secure product liability insurance coverage on acceptable terms or at reasonable costs when needed. Any product recall or lawsuit seeking significant monetary damages may have a material affect on our business and financial condition. Any liability for mandatory damages could exceed the amount of our coverage. Moreover, a product recall could generate substantial negative publicity about our products and business and inhibit or prevent commercialization of other future product candidates. RISKS RELATING TO AN INVESTMENT IN OUR SECURITIES TO DATE, WE HAVE NOT PAID ANY CASH DIVIDENDS AND NO CASH DIVIDENDS WILL BE PAID IN THE FORESEEABLE FUTURE. We do not anticipate paying cash dividends on our common shares in

the foreseeable future, and we cannot assure an investor that funds will be legally available to pay dividends, or that even if the funds are legally available, that the dividends will be paid. THE APPLICATION OF THE "PENNY STOCK" RULES COULD ADVERSELY AFFECT THE MARKET PRICE OF OUR COMMON SHARES AND INCREASE YOUR TRANSACTION COSTS TO SELL THOSE SHARES. As long as the trading price of our common shares is below $5 per share, the open-market trading of our common shares will be subject to the "penny stock" rules. The "penny stock" rules impose additional sales practice requirements on broker-dealers who sell securities to persons other than established customers and accredited investors (generally those with assets in excess of $1,000,000 or annual income exceeding $200,000 or $300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of securities and have received the purchaser's written consent to the transaction before the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the broker-dealer must deliver, before the transaction, a disclosure schedule prescribed by the SEC relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative and current quotations for the securities. Finally, monthly statements must be sent disclosing recent price information on the limited market in penny stocks. These additional burdens imposed on broker-dealers may restrict the ability or decrease the willingness of broker-dealers to sell our common shares, and may result in decreased liquidity for our common shares and increased transaction costs for sales and purchases of our common shares as compared to other securities. OUR COMMON SHARES ARE THINLY TRADED, SO YOU MAY BE UNABLE TO SELL AT OR NEAR ASK PRICES OR AT ALL IF YOU NEED TO SELL YOUR SHARES TO RAISE MONEY OR OTHERWISE DESIRE TO LIQUIDATE YOUR SHARES. Our common shares have historically been sporadically or "thinly-traded" on the OTCBB, meaning that the number of persons interested in purchasing our common shares at or near ask prices at any given time may be relatively small or non-existent. As of June 16, 2006, our average trading volume per day for the past three months was approximately 205,665 shares a day with a high of 1,964,000 shares traded and a low of 43,600 shares traded. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an 29 unproven company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. We cannot give you any assurance that a broader or more active public trading market for our common shares will develop or be sustained, or that current trading levels will be sustained. In May of 2004, we entered into a common stock purchase agreement with Fusion Capital II, LLC ("Fusion"). Under the common stock purchase agreement, Fusion agreed to purchase, on each trading day during the term of the agreement, $10,000 of our common stock. As of June 16, 2006, Fusion can purchase an aggregate of $4,314,999 of common stock over a 30 month period from the Commencement Date. Fusion Capital's purchase of $10,000 of our common stock each trading day could cause our common stock price to decline due to the additional shares available in the market, particularly in light of the relatively thin trading volume of our common stock. Using the closing price on June 15, 2006 of $0.37 as an example, Fusion Capital would be issued approximately 27,027 shares each trading day if we elected to have them purchase the daily purchase amount, whereas our average trading volume for the prior three months is 205,665 per day. The market price of our common stock could decline given our minimal average trading volume compared to the number of shares potentially issuable to Fusion Capital and the voting power and value of your investment would be subject to continual dilution if Fusion Capital purchases the shares and resells those shares into the market, although there is no obligation for Fusion Capital to sell such shares. Any adverse affect on the market price of our common stock would increase the number of shares issuable to Fusion Capital each trading day which would increase the dilution of your investment. Although we have the right to reduce or suspend Fusion Capital purchases at any time, our financial condition at the time may require us to waive our right to suspend purchases even if there is a decline in the market price. Contractual 9.9% beneficial ownership limitations prohibit Fusion Capital, together with its affiliates, from beneficially owning more than 9.9% of our outstanding common stock. This 9.9% limitation does not prevent Fusion Capital from purchasing shares of our common stock and then reselling those shares in stages over time where Fusion Capital and its affiliates do not, at any given time, beneficially own shares in excess of the 9.9%

limitation. Consequently, these limitations will not necessarily prevent substantial dilution of the voting power and value of your investment. THE MARKET PRICE FOR OUR COMMON SHARES IS PARTICULARLY VOLATILE GIVEN OUR STATUS AS A RELATIVELY UNKNOWN COMPANY WITH A SMALL AND THINLY-TRADED PUBLIC FLOAT, LIMITED OPERATING HISTORY AND LACK OF REVENUES WHICH COULD LEAD TO WIDE FLUCTUATIONS IN OUR SHARE PRICE. THE PRICE AT WHICH YOU PURCHASE OUR COMMON SHARES MAY NOT BE INDICATIVE OF THE PRICE THAT WILL PREVAIL IN THE TRADING MARKET. YOU MAY BE UNABLE TO SELL YOUR COMMON SHARES AT OR ABOVE YOUR PURCHASE PRICE, WHICH MAY RESULT IN SUBSTANTIAL LOSSES TO YOU. The market for our common shares is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. In fact, during the 52-week period ended June 15, 2006, the high and low sale prices of a share of our common stock were $0.89 and $0.19, respectively. The volatility in our share price is attributable to a number of factors. First, as noted above, our common shares are sporadically and/or thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our shareholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large number of our common shares are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without adverse impact on its share price. Secondly, we are a speculative or "risky" investment due to our limited operating history and lack of revenues or profits to date, and uncertainty of future market acceptance for our potential products. As a consequence of this enhanced risk, more risk-adverse investors may, under the fear of losing all or most of their investment in the event of negative news or lack of progress, be more inclined to sell their shares on the market more quickly and at greater discounts than would be the case with the stock of a seasoned issuer. The following factors may add to the volatility in the price of our common shares: actual or anticipated variations in our quarterly or annual operating results; acceptance or rejection of our proprietary technology as viable method of augmenting the immune response of clearing viruses and toxins from human blood; government regulations, announcements of significant acquisitions, strategic partnerships or joint ventures; our capital commitments; and additions or departures of our key personnel. Many of these factors are beyond our control and may decrease the market price of our common shares, regardless of our operating performance. We cannot make any predictions or projections as to what the prevailing market price for our common shares will be at any time, including as to whether our common shares will sustain their current market prices, or as to what effect that the sale of shares or the availability of common shares for sale at any time will have on the prevailing market price. 30 Shareholders should be aware that, according to SEC Release No. 34-29093, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include (1) control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer; (2) manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases; (3) boiler room practices involving high-pressure sales tactics and unrealistic price projections by inexperienced sales persons; (4) excessive and undisclosed bid-ask differential and markups by selling broker-dealers; and (5) the wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the resulting inevitable collapse of those prices and with consequent investor losses. Our management is aware of the abuses that have occurred historically in the penny stock market. Although we do not expect to be in a position to dictate the behavior of the market or of broker-dealers who participate in the market, management will strive within the confines of practical limitations to prevent the described patterns from being established with respect to our securities. The occurrence of these patterns or practices could increase the volatility of our share price. VOLATILITY IN OUR COMMON SHARE PRICE MAY SUBJECT US TO SECURITIES LITIGATION. The market for our common shares is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. In the past, plaintiffs have often initiated securities class action litigation against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and liabilities and could divert management's attention and resources. OUR OFFICERS AND DIRECTORS BENEFICIALLY OWN OR CONTROL APPROXIMATELY 31% OF OUR OUTSTANDING COMMON SHARES AS OF JUNE 15, 2006, WHICH MAY LIMIT THE ABILITY OF YOURSELF OR OTHER SHAREHOLDERS, WHETHER ACTING INDIVIDUALLY OR TOGETHER, TO PROPOSE OR DIRECT THE

MANAGEMENT OR OVERALL DIRECTION OF OUR COMPANY. ADDITIONALLY, THIS CONCENTRATION OF OWNERSHIP COULD DISCOURAGE OR PREVENT A POTENTIAL TAKEOVER OF OUR COMPANY THAT MIGHT OTHERWISE RESULT IN YOU RECEIVING A PREMIUM OVER THE MARKET PRICE FOR YOUR COMMON SHARES. As of June 15, 2006, our officers and directors beneficially own or control approximately 31% of our outstanding common shares. These persons will have the ability to control substantially all matters submitted to our shareholders for approval and to control our management and affairs, including extraordinary transactions such as mergers and other changes of corporate control, and going private transactions. A LARGE NUMBER OF COMMON SHARES ARE ISSUABLE UPON EXERCISE OF OUTSTANDING COMMON SHARE PURCHASE OPTIONS, WARRANTS AND CONVERTIBLE PROMISSORY NOTES. THE EXERCISE OR CONVERSION OF THESE SECURITIES COULD RESULT IN THE SUBSTANTIAL DILUTION OF YOUR INVESTMENT IN TERMS OF YOUR PERCENTAGE OWNERSHIP IN THE COMPANY AS WELL AS THE BOOK VALUE OF YOUR COMMON SHARES. THE SALE OF A LARGE AMOUNT OF COMMON SHARES RECEIVED UPON EXERCISE OF THESE OPTIONS OR WARRANTS ON THE PUBLIC MARKET TO FINANCE THE EXERCISE PRICE OR TO PAY ASSOCIATED INCOME TAXES, OR THE PERCEPTION THAT SUCH SALES COULD OCCUR, COULD SUBSTANTIALLY DEPRESS THE PREVAILING MARKET PRICES FOR OUR SHARES. As of June 15, 2006, there are outstanding non-variable priced purchase options and warrants entitling the holders to purchase 16,740,820 common shares at a weighted average exercise price of $0.39 per share. There are 5,000,00 shares underlying promissory notes convertible into common stock at a weighted average exercise price of $ 0.20. The exercise price for all of the aforesaid warrants, may be less than your cost to acquire our common shares. In the event of the exercise of these securities, you could suffer substantial dilution of your investment in terms of your percentage ownership in the company as well as the book value of your common shares. In addition, the holders of the common share purchase options or warrants may sell common shares in tandem with their exercise of those options or warrants to finance that exercise, or may resell the shares purchased in order to cover any income tax liabilities that may arise from their exercise of the options or warrants. OUR ISSUANCE OF ADDITIONAL COMMON SHARES, OR OPTIONS OR WARRANTS TO PURCHASE THOSE SHARES, WOULD DILUTE YOUR PROPORTIONATE OWNERSHIP AND VOTING RIGHTS. We are entitled under our certificate of incorporation to issue up to 50,000,000 shares of common stock. After taking into consideration our outstanding common stock at June 15, 2006, our convertible notes, outstanding options and outstanding warrants we will be entitled to issue up to 21,740,820 additional common shares. Our board may generally issue shares of common stock, or options or warrants to purchase those shares, without further approval by our shareholders based upon such factors as our board of directors may deem relevant at that time. It is likely that we will be required to issue a large amount of additional securities to raise capital to further our development. It is also likely that we will be required to issue a large amount of additional securities 31 to directors, officers, employees and consultants as compensatory grants in connection with their services, both in the form of stand-alone grants or under our stock plans. We cannot give you any assurance that we will not issue additional shares of common stock, or options or warrants to purchase those shares, under circumstances we may deem appropriate at the time. OUR ISSUANCE OF ADDITIONAL COMMON SHARES IN EXCHANGE FOR SERVICES OR TO REPAY DEBT, WOULD DILUTE YOUR PROPORTIONATE OWNERSHIP AND VOTING RIGHTS AND COULD HAVE A NEGATIVE IMPACT ON THE MARKET PRICE OF OUR COMMON STOCK. Our board of directors may generally issue shares of common stock to reduce debt or pay for services without further approval by our shareholders based upon such factors as our board may deem relevant at that time. During the past three fiscal years we issued a total of 4,413,427 shares in exchange for outstanding debt to reduce our obligations. The average price discount of common stock issued to reduce debt for each year, weighted by the number of shares issued for the corresponding periods was 47.4%, 53.4% and 70.0% for the years ended 2004, 2005 and 2006, respectively. During the past three fiscal years we issued a total of 2,790,176 shares in payment for services. The average price discount of common stock issued for services for the corresponding periods, weighted by the number of shares issued in such period was 55.4%, 46.3% and 9.0% for the years ended 2004, 2005 and 2006, respectively. It is likely that we will issue additional securities to pay for services and reduce debt in the future. We cannot give you any assurance that we will not issue additional shares of common stock under circumstances we may deem appropriate at the time. THE SALE OF OUR COMMON STOCK UNDERLYING THE PROMISSORY NOTES AND WARRANTS OWNED BY THE SELLING SHAREHOLDERS MAY CAUSE DILUTION AND THE SALE OF THE SHARES OF

COMMON STOCK ACQUIRED BY SELLING SHAREHOLDERS COULD CAUSE THE PRICE OF OUR COMMON STOCK TO DECLINE. Depending upon market liquidity at the time, a sale of shares under this offering at any given time could cause the trading price of our common stock to decline. The sale of a substantial number of shares of our common stock under this offering, or anticipation of such sales, could make it more difficult for us to sell equity or equity-related securities in the future at a time and at a price that we might otherwise wish to effect sales. THE ELIMINATION OF MONETARY LIABILITY AGAINST OUR DIRECTORS, OFFICERS AND EMPLOYEES UNDER OUR CERTIFICATE OF INCORPORATION AND THE EXISTENCE OF INDEMNIFICATION RIGHTS TO OUR DIRECTORS, OFFICERS AND EMPLOYEES MAY RESULT IN SUBSTANTIAL EXPENDITURES BY OUR COMPANY AND MAY DISCOURAGE LAWSUITS AGAINST OUR DIRECTORS, OFFICERS AND EMPLOYEES. Our certificate of incorporation contains provisions which eliminate the liability of our directors for monetary damages to our company and shareholders. Our bylaws also require us to indemnify our officers and directors. We may also have contractual indemnification obligations under our agreements with our directors, officers and employees. The foregoing indemnification obligations could result in our company incurring substantial expenditures to cover the cost of settlement or damage awards against directors, officers and employees, which we may be unable to recoup. These provisions and resultant costs may also discourage our company from bringing a lawsuit against directors, officers and employees for breaches of their fiduciary duties, and may similarly discourage the filing of derivative litigation by our shareholders against our directors, officers and employees even though such actions, if successful, might otherwise benefit our company and shareholders. ANTI-TAKEOVER PROVISIONS MAY IMPEDE THE ACQUISITION OF OUR COMPANY. Certain provisions of the Nevada General Corporation Law have anti-takeover effects and may inhibit a non-negotiated merger or other business combination. These provisions are intended to encourage any person interested in acquiring us to negotiate with, and to obtain the approval of, our Board of Directors in connection with such a transaction. However, certain of these provisions may discourage a future acquisition of us, including an acquisition in which the shareholders might otherwise receive a premium for their shares. As a result, shareholders who might desire to participate in such a transaction may not have the opportunity to do so. SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS In this prospectus we make a number of statements, referred to as "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 Securities Exchange Act of 1934 (the "Exchange Act"), which are intended to convey our expectations or predictions regarding the occurrence of possible future events or the existence of trends and factors that may impact our future plans and operating results. The safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995 does not apply to us. We note, however, that these forward-looking statements are derived, in part, from various assumptions and analyses we have made in the context of our current business plan and information currently available to us and in light of our experience and perceptions of historical trends, current conditions and expected future developments and other factors we believe to be appropriate in 32 the circumstances. You can generally identify forward-looking statements through words and phrases such as "SEEK", "ANTICIPATE", "BELIEVE", "ESTIMATE", "EXPECT", "INTEND", "PLAN", "BUDGET", "PROJECT", "MAY BE", "MAY CONTINUE", "MAY LIKELY RESULT", and similar expressions. When reading any forward looking statement you should remain mindful that all forward-looking statements are inherently uncertain as they are based on current expectations and assumptions concerning future events or future performance of our company, and that actual results or developments may vary substantially from those expected as expressed in or implied by that statement for a number of reasons or factors, including those relating to: o whether or not markets for our products develop and, if they do develop, the pace at which they develop; o our ability to attract and retain the qualified personnel to implement our growth strategies, o our ability to obtain approval from the Food and Drug Administration for our products; o our ability to protect the patents on our proprietary technology; o our ability to fund our short-term and long-term financing needs; o changes in our business plan and corporate strategies; and o other risks and uncertainties discussed in greater detail in the sections of this prospectus, including those captioned "RISK FACTORS" and "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS". Each forward-looking statement should be read in context with, and with an understanding of, the various other disclosures concerning our company and our business made elsewhere in this prospectus as well as other pubic reports filed with the United States Securities and Exchange Commission (the "SEC"). You should not place undue reliance on any forward-looking statement as a prediction of actual results or

developments. We are not obligated to update or revise any forward-looking statement contained in this prospectus to reflect new events or circumstances unless and to the extent required by applicable law. ITEM 7. FINANCIAL STATEMENTS The financial statements listed in the accompanying Index to Financial Statements are attached hereto and filed as a part of this Report under Item 13. ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE None. ITEM 8A. EVALUATION OF 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 Exchange Act as of a date (the "Evaluation Date") within 90 days prior to filing the Company's March 31, 2006 Form 10-KSB. Based upon that evaluation, our CEO and CFO concluded that, as of March 31, 2006, our disclosure controls and procedures were effective in timely alerting management 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, our CEO and the CFO have also concluded that there are no significant deficiencies in the design or operation of internal controls over financial reporting, at the reasonable assurance level, which are reasonably likely to adversely affect our ability to record, process, summarize and report financial information, and such officers have identified no material weaknesses in our internal controls over financial reporting. CHANGES IN CONTROLS AND PROCEDURES There were no significant changes made in our internal controls over financial reporting during the quarter ended March 31, 2006 that have materially affected or are reasonably likely to materially affect these controls. Thus, no corrective actions with regard to significant deficiencies or material weaknesses were necessary. LIMITATIONS ON THE EFFECTIVENESS OF INTERNAL CONTROL Our management, including the CEO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material errors. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, 33 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. ITEM 8B. OTHER INFORMATION On June 28, 2006, Calvin M. Leung resigned as a director of the Company. The resignation by Mr. Leung was not due to any disagreement with the Company. PART III ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT Section 16(a) of the Securities Exchange Act of 1934 requires our officers, directors, and persons who own more than 10% of a registered class of our equity securities to file reports of ownership and changes in ownership with the SEC and Nasdaq. Officers, directors, and greater than 10% beneficial owners are required by SEC regulation to furnish the Company with copies of all Section 16 (a) forms they file. Based solely on our review of copies of the Section 16(a) reports filed for the fiscal year ended December, 2005, we believe that all filing requirements applicable toits officers, directors, and greater than 10% beneficial owners were complied with. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS The names, ages and positions of our directors and executive officers as of June 15, 2006 are listed below: NAMES TITLE OR POSITION AGE

James A. Joyce (1) Chairman, President, Chief Executive 44 Officer and Secretary Richard H. Tullis, PhD (2) Vice President, Chief Science Officer 60 and Director James W. Dorst (3) Chief Financial Officer 51 Franklyn S. Barry, Jr. Director 66 Edward G. Broenniman Director 69 Calvin M. Leung (4) Director 68 (1) Effective June 1, 2001, Mr. Joyce was appointed our President and Chief Executive Officer,

replacing Mr. Barry, who continues as a member of the board of directors. Mr. Barry also served as a consultant to us on strategic business issues from June 1, 2001 to May 31, 2003. (2) Effective June 1, 2001, Dr. Tullis was appointed as our Chief Science Officer, replacing Dr. Clara M. Ambrus, who retired. (3) Effective August 1, 2005, Mr. Dorst was appointed Chief Financial Officer. (4) Effective June 30, 2003, Mr. Leung was elected to our board of directors. On June 28, 2006, Mr. Leung resigned from the Board of Directors. None of our directors or executive officers has, during the past five years: o been convicted in a criminal proceeding and none of our directors or executive officers is subject to a pending criminal proceeding, o been subject to any order, judgment, or decree not subsequently reversed, suspended or vacated of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities, futures, commodities or banking activities, or 34 o been found by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated. Resumes of Management: James A. Joyce, Chairman, President and CEO Mr. Joyce is the founder of Aethlon Medical, and has been the Chairman of the Board and Secretary since March 1999. On June 1, 2001, our Board of Directors appointed Mr. Joyce with the additional roles of President and CEO. In 1992, Mr. Joyce founded and was the sole shareholder of James Joyce & Associates, an organization that provided management consulting and corporate finance advisory services to CEOs and CFOs of publicly traded companies. Previously, from 1989 to 1991, Mr. Joyce was Chairman and Chief Executive Officer of Mission Labs, Inc. Prior to that Mr. Joyce was a principal in charge of U.S. operations for London Zurich Securities, Inc. Mr. Joyce is a graduate from the University of Maryland. James W. Dorst, Chief Financial Officer Mr. Dorst brings more than 20 years of senior management experience in finance, operations, planning and business transactions to the Company. Prior to joining Aethlon, Mr. Dorst was Vice President of Finance and Operations for VerdiSoft Corporation, a developmental-stage mobile-software developer recently acquired by Yahoo, Inc. (NASDAQ:YHOO). Previously, Mr. Dorst held executive positions as SVP of Finance and Administration at SeeCommerce; COO/CFO of Omnis Technology Corp. (now NASDAQ Small Cap: RDTA); CFO and SVP of Information Technology at Savoir Technology Group, Inc. (acquired by NYSE:AVT). Mr. Dorst practiced as a Certified Public Accountant with Coopers & Lybrand (PricewaterhouseCoopers) and holds an MS in Accounting and BS in finance from the University of Oregon. Richard H. Tullis, Ph.D., Vice President, Chief Science Officer Dr. Tullis has been Vice President and a director of the Company since January 2000 and Chief Science Officer since June 2001. Dr. Tullis has extensive biotechnology management and research experience, and is the founder of Syngen Research, a wholly-owned subsidiary of Aethlon Medical, Inc. Previously, Dr. Tullis co-founded Molecular Biosystems, Inc., a former NYSE company. At Molecular Biosystems, Dr. Tullis was Director of Oligonucleotide Hybridization, Senior Research Scientist and Member of the Board of Directors. In research, Dr. Tullis developed and patented the first application of oligonucleotides to antisense antibiotics and developed new methods for the chemical synthesis of DNA via methoxy-hosphorochloridites. Dr. Tullis also co-developed the first applications of covalently coupled DNA-enzyme conjugates using synthetic oligonucleotides during his tenure at Molecular Biosystems. In 1985, Dr. Tullis founded, and served as President and CEO of Synthetic Genetics, Inc., a pioneer in custom DNA synthesis, which was sold to Molecular Biology Resources in 1991. Dr. Tullis also served as interim-CEO of Genetic Vectors, Inc., which completed its IPO under his management, and was co-founder of DNA Sciences, Inc., a company that was eventually acquired by Genetic Vectors. Dr. Tullis received his Ph.D. in Biochemistry and Cell Biology from the University of California at San Diego, and has done extensive post-doctoral work at UCSD, USC, and the University of Hawaii. Franklyn S. Barry, Jr. Mr. Barry has over 25 years of experience in managing and building companies. He was President and Chief Executive Officer of Hemex from April 1997 through May 31, 2001 and our President and CEO from March 10, 1999 to May 31, 2001. He became a director of Aethlon Medical on March 10, 1999. From 1994 to April 1997, Mr. Barry was a private consultant. Included among his prior experiences are tenures as President of Fisher-Price and as co-founder and CEO of Software Distribution Services, which today operates as Ingram Micro-D, an international distributor of personal computer products. Mr. Barry serves on the Board of Directors of Merchants Mutual Insurance Company. Edward G. Broenniman Mr. Broenniman became a director of Aethlon Medical on March 10, 1999. Mr. Broenniman has 30 years of management and executive experience with high-tech, privately-held growth firms where he has served as a CEO, COO, or corporate advisor, using his expertise to focus management on increasing profitability and stockholder value. He is the Managing Director of The Piedmont Group, LLC, a venture advisory firm. Mr. Broenniman recently served on the Board of Directors of publicly-traded

QuesTech (acquired by CACI International), and currently serves on the Boards of four privately-held firms. His nonprofit Boards are the Dingman Center for Entrepreneurship's Board of Advisors at the University of Maryland, the National Association of Corporate Directors, National Capital Chapter and the Board of the Association for Corporate Growth, National Capital Chapter. 35 Calvin M. Leung Mr. Leung became a director of Aethlon Medical on June 30, 2003. He is the President of Mandarin Investment Corporation, specializing in investment, development and management of mobile home and recreational vehicle parks in California, Arizona and the midwest since 1975. He has syndicated a number of land and housing developments in the western United States. Mr. Leung, born in Hong Kong, received his advanced education in the United States where he was awarded a doctorate degree in psychology specializing in experimental research. He taught at the university level for several years. Mr. Leung resigned from the Board of Directors effective June 28, 2006. Our Board of Directors has the responsibility for establishing broad corporate policies and for overseeing our overall performance. Members of the Board are kept informed of our business activities through discussions with the President and other officers, by reviewing analyses and reports sent to them, and by participating in Board and committee meetings. Our bylaws provide that each of the directors serves for a term that extends to the next Annual Meeting of Shareholders of the Company. Our Board of Directors presently has an Audit Committee and a Compensation Committee on each of which Messrs. Barry, Broenniman and Leung serve. Mr. Barry is Chairman of the Audit Committee, and Mr. Broenniman is Chairman of the Compensation Committee. Upon the recommendation of our Compensation Committee, in February 2005, we adopted our 2005 Directors Compensation Program (the "Directors Compensation Program") which advances our interest by helping us to obtain and retain the services of outside directors services upon whose judgment, initiative, efforts and/or services we are substantially dependent, by offering to or providing those persons with incentives or inducements affording such persons an opportunity to become owners of our capital stock. Under the Directors Compensation Program, a newly elected director will receive a one time grant of a non-qualified stock option of 1.5% of the common stock outstanding at the time of election. The options will vest one-third at the time of election to the board and the remaining two-thirds will vest equally at year end over three years. Additionally, each director will also receive an annual $25,000 non-qualified stock option retainer, $15,000 of which is to be paid at the first of the year to all directors who are on the Board prior to the first meeting of the year and a $10,000 retainer will be paid if a director attends 75% of the meetings either in person, via conference call or other electronic means. The exercise price for the options under the Directors Compensation Program will equal the average closing of the last ten (10) trading days prior to the date earned. At March 31, 2006 under the 2005 Directors Compensation Program, we had issued 1,337,825 options to outside directors and 3,965,450 options to employee-directors for a total of 5,303,275 options. FAMILY RELATIONSHIPS. There are no family relationships between or among the directors, executive officers or persons nominated or charged by us to become directors or executive officers. There are no arrangements or understandings between any two or more of our directors or executive officers. There is no arrangement or understanding between any of our directors or executive officers and any other person pursuant to which any director or officer was or is to be selected as a director or officer, and there is no arrangement, plan or understanding as to whether non-management shareholders will exercise their voting rights to continue to elect the current Board of Directors. There are also no arrangements, agreements or understanding between non-management shareholders that may directly or indirectly participate in or influence the management of our affairs. REGULATORY AND CLINICAL ADVISOR Kenneth R. Michael, Pharm.D. R.A.C. ---------- Dr. Michael is the President of KRM Associates LLC, a regulatory and clinical affairs consulting organization. He is the former VP of Regulatory Affairs and Quality Assurance at Siemens Medical Systems, and he is the founder, past President and Chairman of The Regulatory Affairs Professional Society. He is also the founder of the San Diego Regulatory Affairs Network. SCIENCE ADVISORY BOARD Each person listed below is a current member of our Science Advisory Board. The role of the Science Advisory Board is to provide scientific guidance related to the development of our Hemopurifier(TM) technology. Unlike the members of our Board of Directors, the Science Advisory Board members are not involved in the management or operations of our company. Members of the Science Advisory Board are paid $500 per day for services rendered either on-site or at a mutually agreeable location. 36 Ken Alibek, M.D., Ph.D., D.Sc. ---------- Dr. Alibek is the Executive Director of Education at the National Center for Biodefense at George Mason University (GMU), and is a Distinguished Professor at GMU as well. Dr. Alibek specializes in medical and scientific research dedicated to developing new forms of protection against biological weapons and other infectious diseases. Formerly, Dr. Alibek was a Soviet Army Colonel, and served as First Deputy Chief of the civilian

branch of the Soviet Union's biological weapons program until he defected to the United States in 1992 and subsequently served as a consultant to numerous U.S. government agencies in the areas of medical microbiology, biological weapons defense, and biological weapons nonproliferation. Dr. Alibek has worked with the National Institutes of Health, testified extensively before the U.S. Congress on nonproliferation of biological weapons and is the author of Biohazard: The Chilling True Story of the Largest Covert Biological Weapons Program in the World--Told from Inside by the Man Who Ran It, published by Random House Books. He holds numerous patents, is widely published in science journals, and has provided over 300 lectures and presentations to military and civilian universities, as well as foreign governments. The December 2003 issue of the Acumen Journal of Life Sciences named Dr. Alibek as one of top five biological warfare experts in the nation. Charles Bailey, Ph.D. ---------- Dr. Bailey is the former commander of the U.S. Army Medical Research Institute of Infectious Diseases (USAMRIID). Dr. Bailey has 25 years U.S. Army experience in R&D and management in infectious diseases and biological warfare defense. As an officer of the Defense Intelligence Agency, Dr. Bailey wrote extensively on foreign biological warfare capabilities. Dr. Bailey is currently the Executive Director for Research & International Relations at the National Center for Biodefense at George Mason University (GMU), and is a Distinguished Professor of Biology at GMU as well. The Acumen Journal of Life Sciences named Dr. Bailey as one of the top five biological warfare experts in the nation. Joseph A. Bellanti, M.D. ---------- Dr. Bellanti is the Director of the International Center for Immunology and Professor of Pediatrics at Georgetown University School of Medicine. He has authored over 400 scientific articles and 25 books and book chapters in the areas of Immunology and Virology. Dr. Bellanti's textbook, "Immunology," is used in medical and graduate schools throughout the country. Larry Cowgill, D.V.M., Ph.D. ---------- Dr. Cowgill is a Professor in the Department of Medicine and Epidemiology at the School of Veterinary Medicine, University of California--Davis and has nearly 30 years of experience as a clinical instructor in small animal internal medicine, nephrology and hemodialysis. He currently Heads the Companion Animal Hemodialysis Units at the Veterinary Medical Teaching Hospital at UC Davis and the UC Veterinary Medical Center-San Diego. Dr. Cowgill is also Associate Dean for Southern California Clinical Programs and is Co-Director of the University of California Veterinary Medical Center-San Diego. Prior to his appointment at the University of California, he was a National Institutes of Health (NIH) Special Research Fellow at the University of Pennsylvania School of Veterinary Medicine and at the Renal Electrolyte Section at the University of Pennsylvania School of Medicine, where he conducted research in basic renal physiology and clinical nephrology. Dr. Cowgill received his D.V.M. from the University of California--Davis School of Veterinary Medicine and his Ph.D. in Comparative Medical Sciences from the University of Pennsylvania, where he also completed his internship and Residency training in Small Animal Internal Medicine. He became a Diplomat of the American College of Veterinary Internal Medicine in 1977. Dr. Cowgill has published extensively in the area of veterinary nephrology and has established a Clinical Fellowship in Renal Medicine and Hemodialysis, which is the first of its kind in veterinary Medicine. Pedro Cuatrecasas, M.D. ---------- Dr. Cuatrecasas was President of the Pharmaceutical Research Division of Parke-Davis Co., and Corporate Vice President for Warner Lambert Company from 1989 until his retirement in 1997. From 1986 to 1989, he served as SVP and Director of Glaxo Inc. For the prior ten years, he was VP/R&D and Director, of the Burroughs Wellcome Company. During his career in pharmaceutical research, he was involved in the discovery, development and marketing registration of more than 40 novel medicines. Dr. Cuatrecasas is widely recognized for the invention and development of affinity chromatography which is a method for the selective capture of proteins, sugars, fats and inorganic compounds. He is a member of the National Academy of Sciences, The Institute of Medicine, and the American Academy of Arts & Sciences, and he has authored more than 400 original publications. 37 Nathan W. Levin, M.D. ---------- Dr. Levin is recognized as a leading authority within the hemodialysis industry. He is the Medical and Research Director of the Renal Research Institute, LLC, a joint venture between Fresenius Medical Care - North America and Beth Israel Medical Center, New York. Dr. Levin also serves as Professor of Clinical Medicine at the Albert Einstein College of Medicine. Raveendran (Ravi) Pottathil, Ph.D. ---------- Dr. Pottathil was the Section Manager for Retroviruses (focus on HIV and HCV) and Tumor markers and PCR diagnostics at Hoffman La Roche from 1985 to 1992. He then co-founded Specialty Biosystems, Inc, a venture of Specialty Labs, one of the largest independent reference laboratories in California. Dr. Pottathil has also advised the World Health Organization's Sexually Transmitted Diseases and Global Vaccination Program. Dr. Pottathil has worked with Dr. Robert Huebner of the NIH in immunology and virology at The Jackson Laboratory, and with Drs. David Lang and Wolfgang Joklik at Duke University on interferons, anti-tumor RNAs and

antigenic suppression of tumorigenic retroviruses. Academic positions include: Assistant Professor at the University of Maryland School of Medicine; Associate Professor at the City of Hope Medical Center in Duarte, California where he published extensively with Dr. Pedro Cuatrecasas (one of developers of affinity chromatography); and Adjunct Professor in Cellular and Molecular Biology at Down State Medical Center and Rutgers University. As a virologist and molecular biologist, Dr. Pottathil has over 40 refereed publications to his credit and has been a Director of OncQuest, Inc., GeneQuest, Inc., Specialty Laboratories Asia in Singapore and Specialty Ranbaxy in India. Currently, Dr. Pottathil is the President of AccuDx, Inc. a pharmaceutical diagnostics company he founded in 1996. Claudio Ronco, M.D. ---------- Dr. Ronco is the Director of the Dialysis and Renal Transplantation Programs of St. Bartolo Hospital in Vicenza, Italy. He has published 17 books on nephrology and dialysis and has written or co-authored over 350 scientific articles. Dr. Ronco also serves on the editorial board of 12 scientific journals, is a director of three international scientific societies, and is recognized as being instrumental in the introduction of continuous hemofiltration and high flux dialysis in Europe. Members of the Scientific Advisory Board do not receive any monetary compensation for service on the Board. However, on occasion, the members may be awarded stock options. INVOLVEMENT IN LEGAL PROCEEDINGS. To the best of our knowledge, during the past five years, none of the following occurred with respect to a present or former director or executive officer of the Company: (1) any bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time; (2) any conviction in a criminal proceeding or being subject to a pending criminal proceeding (excluding traffic violations and other minor offenses); (3) being subject to any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of any competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities or banking activities; and (4) being found by a court of competent jurisdiction (in a civil action), the SEC or the Commodities Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended or vacated. 38 CODE OF ETHICS. On February 23, 2005, the Board of Directors approved a "Code of Business Conduct and Ethics." ITEM 10. EXECUTIVE COMPENSATION The following table sets forth compensation received for the fiscal years ended March 31, 2004 through 2006 by our Chief Executive Officer and all other executive officers. LONG TERM COMPENSATION ---------- ANNUAL COMPENSATION AWARDS PAYOUTS ---------- ---------- --------- SECURITIES LONG ALL NAMED EXECUTIVE OFFICER AND UNDERLYING TERM OTHER PRINCIPAL POSITION RESTRICTED OPTIONS INCENTIVE COMP- YEAR SALARY(1) BONUS OTHER STOCK & SARS PLAN ENSATION ---------- James A. Joyce 2006 $ 224,712 $ -- $ -- $ -- 2,857,148 (2) -- $ -- PRESIDENT AND CHIEF 2005 187,291 20,000 -- -- 2,231,100 -- -- EXECUTIVE OFFICER 2004 180,000 -- -- -- -- -- -- Richard H. Tullis, Ph.D 2006 $ 165,000 $ -- $ -- $ -- -- $ -- $ -- VICE PRESIDENT AND CHIEF 2005 154,375 15,000 -- 1,734,750 -- -- SCIENCE OFFICER 2004 150,000 -- -- -- -- -- James W. Dorst (3) 2006 $ 93,750 $ -- 500,000 $ -- $ -- CHIEF FINANCIAL OFFICER 2005 N/A -- -- -- -- -- 2004 N/A -- -- -- -- -- -- (1) The remuneration described in the above table excludes our cost of benefits furnished to the named executive officers, including premiums for health insurance and other personal benefits provided to such individuals that are extended to all of our employees in connection with their employment. Perquisites and other personal benefits, securities, or property received by an executive officer are either the lesser of $50,000 or 10% of the total salary and bonus reported for each named executive officer, except as otherwise disclosed. (2) On September 9, 2005, the Company's board of directors approved and the Company entered into a Stock Option Agreement with Mr. James A Joyce, the Company's Chief Executive Officer in exchange for the cancellation of $300,000 of debt owed to Mr. Joyce. the Stock Option Agreement provides for a fully-vested, non-qualified, ten-year option to purchase restricted common stock with an exercise price of $0.21 per share. On September 9, 2005 the market closing price per share of the Company's common stock was $0.20. (3) James W. Dorst was appointed Chief financial Officer August 1, 2005. Mr. Dorst receives an annual salary of $150,000 and was granted nonqualified stock options to purchase 500,000 shares of common stock at an exercise price equal to the fair market value of the stock on the date of grant. STOCK OPTIONS AND STOCK APPRECIATION RIGHTS GRANT TABLE The following table provides certain information with respect to individual grants during the last fiscal year to each of our named executive officers of common share purchase options or stock appreciation rights ("SARs") relating to our common shares: COMMON SHARES AS PERCENTAGE OF UNDERLYING GRANT OF GRANTS TO ALL EXERCISE OR NAMED

EXECUTIVE OFFICER OPTIONS OR SARS EMPLOYEES BASE PRICE EXPIRATION DATE ---------- ---------- ---------- ---------- ---------- James A. Joyce, CHAIRMAN, PRESIDENT AND CEO 2,857,148 85.1% $0.21 9/9/2015 James W. Dorst CHIEF FINANCIAL OFFICER 500,000 14.9% $0.23 8/1/2010 STOCK OPTIONS AND STOCK APPRECIATION RIGHTS EXERCISE AND VALUATION TABLE The following table sets forth the number of common stock options, both exercisable and unexercisable, held by each of our Named Executive Officers and the value of any in-the-money options at June 15, 2006, utilizing a value of $0.37 per share, the closing price of the Company's common stock on the Over-The-Counter Bulletin Board on June 15, 2006: 39 NUMBER OF SECURITIES UNDERLYING VALUE OF UNEXERCISED UNEXERCISED IN-THE-MONEY SHARES OPTIONS/SARS OPTIONS/SARS ACQUIRED VALUE (EXERCISABLE/ (EXERCISABLE/ NAMED EXECUTIVE OFFICER ON EXERCISE REALIZED UNEXERCISABLE) UNEXERCISABLE) ---------- ---------- ---------- ---------- ---------- James A. Joyce -- -- 4,530,468 / 557,775 $440,410 / $0 Richard H. Tullis -- -- 1,580,763 / 433,587 $0 / $0 James W. Dorst -- -- 0 / 500,000 $0 / $70,000 EMPLOYMENT AGREEMENTS We entered into an employment agreement with Mr. Joyce effective April 1, 1999. Effective June 1, 2001, Mr. Joyce was appointed President and Chief Executive Officer and his base annual salary was increased from $120,000 to $180,000. Effective January 1, 2005, Mr. Joyce's salary was increased from $180,000 to $205,000 per year. Under the terms of the agreement, his employment continues at a salary of $205,000 per year for successive one year periods, unless given notice of termination 60 days prior to the anniversary of his employment agreement. Effective April 1, 2006. Mr. Joyce's salary was increased from $205,000 to $240,000. We entered into an employment agreement with Dr. Tullis effective January 10, 2000. Effective June 1, 2001, Dr. Tullis was appointed our Chief Science Officer of the Company. His compensation under the agreement was modified in June 2001 from $80,000 to $150,000 per year. Effective January 1, 2005 Dr. Tullis' salary was increased from $150,000 to $165,000 per year Under the terms of the agreement, his employment continues at a salary of $165,000 per year for successive one-year periods, unless given notice of termination 60 days prior to the anniversary of his employment agreement. Dr. Tullis was granted 250,000 stock options to purchase our common stock in connection the completing certain milestones, such as the initiation and completion of certain clinical trials, the submission of proposals to the FDA and the filing of a patent application. Effective April 1, 2006, Dr. Tullis salary was increased to $185,000 per year. Both Mr. Joyce's and Dr. Tullis' agreements provide for medical insurance and disability benefits, one year of severance pay if their employment is terminated by us without cause or due to change in our control before the expiration of their agreements, and allow for bonus compensation and stock option grants as determined by our Board of Directors. Both agreements also contain restrictive covenants preventing competition with us and the use of confidential business information, except in connection with the performance of their duties for the Company, for a period of two years following the termination of their employment with us. STOCK OPTION GRANTS Our 2000 Stock Option Plan (the "Plan"), adopted by us in August 2000, provides for the grant of incentive stock options ("ISOs") to full-time employees (who may also be Directors) and nonstatutory stock options ("NSOs") to non-employee Directors, consultants, customers, vendors or providers of significant services. The exercise price of any ISO may not be less than the fair market value of our Common Stock on the date of grant or, in the case of an optionee who owns more than 10% of the total combined voting power of all classes of our outstanding stock, not be less than 110% of the fair market value on the date of grant. The exercise price, in the case of any NSO, must not be less than 75% of the fair market value of our Common Stock on the date of grant. The amount available under the Plan is 500,000 options. Under the Directors Compensation Program, adopted by us in February 2005, a newly elected director will receive a one time grant of a non-qualified stock option of 1.5% of the common stock outstanding at the time of election. The options will vest one-third at the time of election to the board and the remaining two-thirds will vest equally at year end over three years. Additionally, each director will also receive an annual $25,000 non-qualified stock option retainer, $15,000 of which is to be paid at the first of the year to all directors who are on the Board prior to the first meeting of the year and a $10,000 retainer will be paid if a director attends 75% of the meetings either in person, via conference call or other electronic means. The exercise price for the options under the Directors Compensation Program will equal the average closing of the last ten (10) trading days prior to the date earned. At March 31, 2006 under the 2005 Directors Compensation Program we had issued 1,337,825 options to outside directors and 3,965,450 options to employee-directors for a total of 5,303,275 options. 40 At March 31, 2006, we had granted 32,500 options under the 2000 Stock Option Plan, with 467,500 available for future issuance. At March 31, 2006 we had issued 5,303,275

options under the Directors Compensation Plan. We issued 5,328,158 options (of which 1,773,300 have been exercised or cancelled) outside both the 2005 Directors Compensation Plan and 2000 Stock Option Plan. At March 31, 2006, we had outstanding options to purchase 8,812,785 shares of our Common Stock. See Item 11, "Security Ownership of Certain Beneficial Owners and Management." OUTSTANDING STOCK PURCHASE WARRANTS Common Stock purchase warrants At March 31, 2006, we had outstanding a total of 8,343,035 warrants, exercisable at prices between $0.18 - 4.00 per share and with expiration dates from 2006 - 2011. See Item 11, "Security Ownership of Certain Beneficial Owners and Management." ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT The following table sets forth, as of June 30, 2006, information with respect to the shares of Common Stock beneficially owned by (i) each director nominee; (ii) each person (other than a person who is also a director nominee) who is an executive officer; and (iii) all executive officers and directors as a group. The term "executive officer" is defined as the President/Chief Executive Officer, Secretary, Chief Financial Officer/Treasurer, any vice-president in charge of a principal business function (such as administration or finance), or any other person who performs similar policy making functions for the Company. We believe that each individual or entity named has sole investment and voting power with respect to shares of common stock indicated as beneficially owned by them, subject to community property laws where applicable, excepted where otherwise noted: AMOUNT AND NATURE OF PERCENT OF TITLE OF CLASS NAME BENEFICIAL OWNERSHIP(1)(2) CLASS ---------- ---------- ---------- ---------- Common Stock James A. Joyce, Chief Executive Officer and Director 5,130,468 shares (3) 17.0% 3030 Bunker Hill Street, Suite 4000, San Diego, CA 92109 Common Stock Calvin M. Leung, Director 2,407,405 shares(4) 9.3% P.O. Box 2366 Costa Mesa, CA 92628 Common Stock Richard H. Tullis, Chief Scientific Officer and Director 1,638,763 shares(5) 6.0% 3030 Bunker Hill Street, Suite 4000, San Diego, CA 92109 Common Stock Franklyn S. Barry, Director 3030 Bunker Hill Street, Suite 4000, 368,647 shares(6) 1.4% San Diego, CA 92109 Common Stock Edward G. Broenniman, Director 3030 Bunker Hill Street, Suite 4000, 601,561 shares(7) 2.3% San Diego, CA 92109 Common Stock James W. Dorst 3030 Bunker Hill Street, Suite 4000, 165,000 shares (8) * San Diego, CA 92109 All Current Directors and Executive Officers as a Group (6 10,311,844 Shares 31.2% members) *Less than 1%. 1. Based on 25,602,326 shares of Common Stock outstanding on the transfer records as of June 15, 2006. 2. Calculated pursuant to Rule 13d-3(d)(1) of the Securities Exchange Act of 1934. Under Rule 13d-3(d)(1), shares not outstanding which are subject to options, warrants, rights or conversion privileges exercisable within 60 days are deemed outstanding for the purpose of calculating the number and percentage owned by such person, but not deemed outstanding for the purpose of calculating the percentage owned by each other person listed. The Company believes that each individual or entity named has sole investment and voting power with respect to shares of Common Stock indicated as beneficially owned by them, subject to community property laws, where applicable, except where otherwise noted. 41 3. Includes 1,673,325 stock options exercisable at $0.38 per share and 2,857,143 stock options exercisable at $0.21 per share. 4. Includes all shares owned by members of Mr. Leung's family and entities he controls, 190,000 warrants to purchase common stock at exercise prices between $0.25 and $3.00, and 231,546 stock options exercisable at $0.38 per share. Mr. Leung resigned as director of the Company effective June 28, 2006. 5. Includes 250,000 stock options exercisable at $1.90 per share, 30,000 stock options execisable at $3.00 per share and 1,300,763 stock options exercisable at $0.38 per share. 5. Includes 250,000 stock options exercisable at $1.90 per share, 30,000 stock options exercisable at $2.56 per share and 867,175 at $0.38 per share. 6. 30,675 stock options exercisable at $0.489 per share and 205,816 stock options exercisable at $0.38 per share. 7. Includes 53,885 shares owned by Mr. Broenniman's wife, his 3,000 stock options exercisable at $1.78, 2,500 stock options exercisable at $3.75, and 360,187 stock options exercisable at $0.38 per share. 8. Includes 165,000 stock options exercisable at $0.23, vesting August 1, 2006. ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS Franklyn S. Barry, Jr., a director and shareholder of Aethlon Medical, was engaged as a consultant to the Company on strategic and business issues from June 1, 2001 to May 31, 2003 and was paid $60,000 per year. Mr. Barry had been our original President and Chief Executive Officer and served in such capacities until 2001. When Mr. Barry stepped down as our President and Chief Executive Officer was owed severance equal to one year salary. The consulting agreement was in lieu of immediate payment to spread the payment of the course of the agreement and to ensure that Mr. Barry provided transition consultation to Mr. Joyce on company practices and maintained and manage relationships with certain employees and vendors. See Item 9, "Directors and Executive Officers" and Item 11, "Security Ownership of Certain Beneficial Owners and Management." Calvin M. Leung, a former director (resigned as of June 28, 2006) and shareholder of Aethlon Medical,

was previously engaged as our consultant providing as needed business advisory services to management, including business development services and introductions to potential investors and merger candidates, and he and his affiliates have invested approximately $939,500 in Aethlon Medical to date, through equity and convertible debt securities. $448,000 was invested via convertible promissory notes from November 2001 through May 2002. The notes accrued interest at rates ranging from 6.75% to 12% per annum. Mr. Leung invested $300,000 via the exercise of stock options received while our consultant for which he received 600,000 shares of restricted common stock. Mr. Leung and his affiliates also invested during 2003 a total of $146,500 in cash for 586,000 shares of our restricted common stock. Finally, Mr. Leung and his affiliates invested approximately $45,000 from September 2003 to February 2004 via the exercise of warrants that resulted in the issuance of 180,000 shares of our restricted common stock. Mr. Leung worked as our consultant from January 7, 2001 to January 7, 2003. We do not expect Mr. Leung to provide consulting services now that he is no longer a member of our Board of Directors. He currently owns 1,985,859 of our common shares, 231,546 options to purchase common stock at $0.38 per share and 190,000 warrants to purchase common stock at exercise prices of between $0.25 and $3.00 per share. (See ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT). Certain of our officers and other related parties have advanced us funds, agreed to defer compensation or paid expenses on behalf of us to cover short-term working capital deficiencies in the aggregate amount of approximately $1,178,000. Of this amount, we owe Dr. Richard H Tullis, our Chief Scientific Officer approximately $267,900 in deferred salary. We also owe our former Chief Financial Officer, Mr. Edward C Hall, approximately $38,111 in deferred salary. We owe Mr. Franklyn S Barry, a director, a total of approximately $289,848 for deferred salary and consulting fees from pre-merger in 1999 through May 2003. We owe approximately $46,475 to James Joyce and Associates, a company founded by our current Chief Executive Officer, for deferred consulting fees on services provided prior to our merger in 1999. We previously repaid Mr. Barry a total of $30,000 in cash. Additionally, we owe John Murray, our former Chief Financial Officer, a total of approximately $25,000 for deferred salary and medical benefits for services rendered from September 2000 through May 2001. We owe Robert S. Stefanovich, a former Chief Financial Officer, a total of approximately $91,000 for deferred salary, vacation and medical benefits for services rendered from July 2001 until July 2002. Additionally, we owe Dr. Clara Ambrus, the founder of Hemex, Inc., approximately $190,500 for services rendered from pre-merger in 1999 through March 2002. We owe Edward Broenniman, a board member, and Linda Broenniman, his wife, an aggregate of approximately $174,000 for services rendered prior to our merger in 1999. Mr. Broenniman has been paid a total of $30,000 against this debt. We owe approximately $34,500 to directors for deferred directors' fees. These non interest-bearing liabilities have been included as due to related parties in the accompanying financial statements. 42 Effective January 1, 2000, we entered into an agreement with Dr. Julian Ambrus, the son of Dr. Clara Ambrus, who was the original founder of Hemex, Inc. Under this agreement, an invention and related patent rights for a method of removing HIV and other viruses from the blood using the Hemopurifier(TM) were assigned to us by the inventors in exchange for (a) a royalty to be paid on future sales of the patented product or process equal to 8.75% of net sales, as defined and (b) 12,500 shares of our restricted common stock. Upon the issuance of the first United States patent relating to the invention, we were obligated to issue an additional 12,500 shares of our restricted common stock to the inventors. If the market price of our common stock on the date the patent was issued was below $8 per share, the number of shares to be issued was that amount which equates to $100,000 of market value. On March 4, 2003, the related patent was issued and, as a result, we issued 196,078 shares of our restricted common stock. Such shares were recorded at par value since the original patent acquisition purchase transaction had been measured at $100,000 and recorded as "patents" in the March 2000 consolidated balance sheet. The 196,078 shares merely satisfied a contingent obligation under the original purchase agreement. We believe that each of the related party transactions above, due to their related party nature, are not necessarily on terms that would have been obtained from unaffiliated third parties. ITEM 13. EXHIBITS The following documents are filed as part of this report on Form 10-KSB: 1. Consolidated Financial Statements for the periods ended March 31, 2006 and 2005: Independent Auditors' Reports Consolidated Balance Sheet Consolidated Statements of Operations Consolidated Statements of Cash Flows Consolidated Statements of Stockholders' Deficit Notes to Consolidated Financial Statements 2. Exhibits 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) 10.1 Employment Agreement between Aethlon Medical, Inc. and James A. Joyce dated April 1, 1999 (4) 10.2 Agreement and Plan of Reorganization Between Aethlon Medical, Inc. and Aethlon, Inc. dated March

10, 1999 (5) 10.3 Agreement and Plan of Reorganization Between Aethlon Medical, Inc. and Hemex, Inc. dated March 10, 1999 (5) 10.4 Agreement and Plan of Reorganization Between Aethlon Medical, Inc. and Syngen Research, Inc. (6) 10.5 Agreement and Plan of Reorganization Between Aethlon Medical, Inc. and Cell Activation, Inc. (7) 10.6 Common Stock Purchase Agreement between Aethlon Medical, Inc. and Fusion Capital Fund II, LLC. (8) 10.7 Registration Rights Agreement between Aethlon Medical, Inc. and Fusion Capital Fund II, LLC. (8) 10.8 Form of Securities Purchase Agreement for Private Placement closing on June 7, 2004 (8) 10.9 Form of Common Stock Purchase Warrant for Private Placement closing on June 7, 2004 (8) 10.10 Form of Registration Rights Agreement for Private Placement closing on June 7, 2004 (8) 10.11 Note Purchase Agreement by and between Aethlon Medical, Inc. and Fusion Capital Fund II, LLC, dated May 16, 2005.(9) 10.12 Convertible Promissory Note by and between Aethlon Medical, Inc. and Fusion Capital Fund II, LLC, dated May 16, 2005.(9) 43 10.13 Form of Common Stock Cashless Purchase Warrant for benefit of Fusion Capital Fund II, LLC, dated May 16, 2005. (9) 10.14 2003 Consultant Stock Plan (10) 10.15 Lease by and between Aethlon Medical, Inc. and San Diego Science Center (11) 10.16 Consulting Agreement by and between Aethlon Medical, Inc. and Jean-Claude Chermann, PhD (11) 10.17 Consulting Agreement by and between Aethlon Medical, Inc. and Franklyn S. Barry, Jr. (11) 10.18 Patent License Agreement by and amongst Aethlon Medical, Inc., Hemex, Inc., Dr. Julian L. Ambrus and Dr. David O. Scamurra (11) 10.19 Employment Agreement by and between Aethlon Medical, Inc. and Dr.Richard H. Tullis (11) 10.20 Employment Agreement by and between Aethlon Medical, Inc. and Edward C. Hall (11) 10.21 Cooperative Agreement by and between Aethlon Medical, Inc. and George Mason University (12) 10.22 Consulting Agreement by and between Aethlon Medical, Inc. and Dr. Charles Bailey (13) 10.23 Consulting Agreement by and between Aethlon Medical, Inc. and Dr. Ken Alibek (13) 10.24 Stock Option Agreement by and between Aethlon Medical, Inc. and James A Joyce (14) 10.25 Stock Option Agreement by and between Aethlon Medical, Inc. and Richard Tullis (14) 10.26 Stock Option Agreement by and between Aethlon Medical, Inc. and Franklyn S. Barry (14) 10.27 Stock Option Agreement by and between Aethlon Medical, Inc. and Ed Broenniman (14) 10.28 Stock Option Agreement by and between Aethlon Medical, Inc. and Calvin Leung (14) 10.29 Warrant for the benefit of Richardson and Patel, LLP (14) 10.30 Stock Option Agreement by and between Aethlon Medical, Inc. and James A. Joyce(15) 10.31 10% Series A Convertible Note by and between Aethlon Medical, Inc. and Allan S. Bird(16) 10.32 10% Series A Convertible Note by and between Aethlon Medical, Inc. and Ellen R. Weiner Family Revocable Trust(16) 10.33 Form of Warrant for Series A Convertible Noteholders(16) 10.34 Form of Registration Rights Agreement for Series A Convertible Noteholders(16) 10.35 Employment Agreement by and between Aethlon Medical, Inc. and James Dorst(17) 10.36 10% Series A Convertible Note by and between Aethlon Medical, Inc. and Christian Hoffmann(18) 10.37 10% Series A Convertible Note by and between Aethlon Medical, Inc. and Claypoole Capital, LLC(18) 10.38 Form of Warrant for additional Series A Convertible Noteholders(18) 10.39 Form of Registration Rights Agreement for additional Series A Convertible Noteholders(18) 10.40 Option Agreement by and between Aethlon Medical, Inc. and Trustees of Boston University(19) 10.41 Warrant for the benefit of Fustion Capital Fund II, LLC(20) 44 21 List of subsidiaries (21) 23.1 Consent of Independent Registered Public Accounting Firm (Squar, Milner, Reehl & Williamson, LLP) * 31.1 Certification of our Chief Executive Officer and President, pursuant to Securities Exchange Act rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002.* 31.2 Certification of our Chief Financial Officer, pursuant to Securities Exchange Act rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002.* 32 Statement of our Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)* 99.1 Resignation Letter dated June 28, 2006 from Calvin Leung* * 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 Annual Report on Form 10-KSB for the year ended March 31, 1999 and incorporated by reference. (5) Filed with the Company's Current Report on Form 8-K dated March 10, 1999 and incorporated by reference. (6) Filed with the Company's Current Report on Form 8-K dated January 10, 2000 an incorporated by reference. (7) Filed with the Company's Current Report on Form 8-K dated April 10, 2000 and incorporated by reference. (8) Filed with the Company's Current Report on Form 8-K dated June 7, 2004 and incorporated by reference. (9) Filed with the Company's Current Report on Form 8-K dated May 16, 2005 and incorporated by reference. (10) Filed with the Company Registration Statement on Form S-8 (File No. 333-114017) filed on August 29, 2005 and incorporated by reference. (11) Filed with the Company's Annual Report on Form 10-KSB/A for the

year ended March 31, 2004 and incorporated by reference. (12) Filed with the Company's Amendment No.2 to Registration Statement on Form SB-2 filed on October 28, 2004 and incorporated by reference. (13) Filed with the Company's Amendment No. 3 to Registration Statement on Form SB-2 (File No. 333-117203) filed on November 24, 2004 and incorporated by reference. (14) Filed with the Company's Annual Report on Form 10-KSB for the year ended March 31, 2005 and and incorporated by reference. (15) Filed with the Company's Current Report on Form 8-K filed on September 12, 2005 and incorporated by reference. (16) Filed with the Company's Current Report on Form 8-K filed on November 7, 2005 and incorporated by reference. (17) Filed with the Company's Post-Effective Amendment to Registration Statement on Form SB-2 filed on December 8, 2005 and incorporated by reference. (18) Filed with the Company's Registration Statement on Form SB-2 (File No. 333-130915) filed on January 9, 2006 and incorporated by reference. (19) Filed with the Company's Current Report on Form 8-K filed on February 23, 2006 and incorporated by reference. (20) Filed with the Company's Current Report on Form 8-K filed on April 4, 2006 and incorporated by reference. (21) Filed with the Company's Registration Statement on Form SB-2 filed on July 7, 2004 and incorporated by reference. 45 ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES The following table presents fees for professional services rendered by Squar, Milner, Reehl & Williamson LLP ("Squar Milner") for the annual audit of our consolidated financial statements as of and for the fiscal years ended March 31, 2006, and 2005 and fees billed for other services rendered by Squar Milner during such years: Fiscal Years Ended March 31, 2006 2005 ------- ------- Audit Fees $86,000 $63,140 Audit Related Fees 47,050 43,754 Tax Fees - - All Other Fees - - ---------- $123,050 $106,894 ========== POLICY ON AUDIT COMMITTEE PRE-APPROVAL OF AUDIT AND PERMISSIBLE NON-AUDIT SERVICES OF INDEPENDENT AUDITOR Our audit committee of the Board of Directors is responsible for pre-approving all audit and permitted non-audit services to be performed for us by our independent auditor. 46 SIGNATURES In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 28th day of June, 2006. BY: /S/ JAMES A. JOYCE ---------- JAMES A. JOYCE CHAIRMAN, PRESIDENT & CHIEF EXECUTIVE OFFICER BY: /S/ JAMES W. DORST ---------- JAMES W. DORST CHIEF FINANCIAL OFFICER In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. SIGNATURE TITLE DATE --------- ----- ---- /S/ JAMES A. JOYCE CHAIRMAN OF THE BOARD JUNE 28, 2006 ---------- JAMES A. JOYCE /S/ FRANKLYN S. BARRY, JR. DIRECTOR JUNE 28, 2006 ---------- FRANKLYN S. BARRY, JR. /S/ EDWARD G. BROENNIMAN DIRECTOR JUNE 28. 2006 ---------- EDWARD G. BROENNIMAN /S/ RICHARD H. TULLIS DIRECTOR JUNE 28, 2006 ---------- RICHARD H. TULLIS 47 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 INDEX TO FINANCIAL STATEMENTS Report of Independent Registered Public Accounting Firm..... F-1 Consolidated Balance Sheet ..... F-2 Consolidated Statements of Operations ..... F-3 Consolidated Statements of Stockholders' Deficit..... F-4 Consolidated Statements of Cash Flows ..... F-13 Notes to Consolidated Financial Statements..... F-15 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM To the Board of Directors and Stockholders Aethlon Medical, Inc. and Subsidiaries We have audited the accompanying consolidated balance sheet of Aethlon Medical, Inc. and Subsidiaries (the "Company"), a development stage company, as of March 31, 2006 and the related consolidated statements of operations, stockholders' deficit and cash flows for each of the years in the two-year period then ended and for the period from January 31, 1984 (Inception) to March 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Aethlon Medical, Inc. and Subsidiaries as of March 31, 2006 and the consolidated

results of their operations and their cash flows for each of the years in the two-year period then ended and for the period from January 31, 1984 (Inception) to March 31, 2006, in conformity with accounting principles generally accepted in the United States of America. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has suffered continuing losses from operations, is in default on certain debt, has negative working capital of approximately $1,921,000 and a deficit accumulated during the development stage of approximately $22,062,000 at March 31, 2006. As discussed in Note 1 to the consolidated financial statements, 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. These conditions, among others, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans regarding these matters are also described in Note 1. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. /S/ SQUAR, MILNER, REEHL & WILLIAMSON, LLP JUNE 27, 2006 NEWPORT BEACH, CALIFORNIA F-1 ---------- AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED BALANCE SHEET MARCH 31, 2006 ---------- ASSETS CURRENT ASSETS Cash $ 836,377 Prepaid expenses 32,222 ---------- TOTAL CURRENT ASSETS 868,599 NON-CURRENT ASSETS Property and equipment, net 12,378 Patents, net 131,599 Other assets 17,200 ---------- TOTAL ASSETS $ 1,029,776 ========== LIABILITIES AND STOCKHOLDERS' DEFICIT CURRENT LIABILITIES Accounts payable and accrued liabilities $ 880,773 Due to related parties 1,238,624 Notes payable, net of discounts 527,500 Convertible notes payable, net of discounts 142,365 ---------- TOTAL CURRENT LIABILITIES 2,789,262 ---------- COMMITMENTS AND CONTINGENCIES STOCKHOLDERS' DEFICIT Common stock, par value of $0.001, 50,000,000 shares authorized; 25,383,706 issued and outstanding 25,384 Additional paid-in capital 20,322,494 Deferred consulting fees (44,917) Deficit accumulated during the development stage (22,062,447) ---------- TOTAL STOCKHOLDERS' DEFICIT (1,759,486) ---------- TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT $ 1,029,776 ========== ---------- SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. F-2 ---------- AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006 ---------- JANUARY 31, 1984 (INCEPTION) THROUGH 2006 2005 MARCH 31, 2006 ---------- Grant income $ -- $ -- $ 1,424,012 Subcontract income -- -- 73,746 Sale of research and development -- -- 35,810 ---------- -- -- 1,533,568 OPERATING EXPENSES Professional fees 851,594 748,837 5,238,135 Payroll and related 675,171 1,000,324 7,246,005 General and administrative 486,452 434,216 4,432,031 Impairment 81,722 -- 1,313,253 ---------- 2,094,939 2,183,377 18,229,424 ---------- OPERATING LOSS (2,094,939) (2,183,377) (16,695,856) OTHER (INCOME) EXPENSE Change in fair value of warrant liability 360,125 -- 360,125 Interest expense (credit) 450,297 (86,426) 4,871,452 Interest income -- -- (17,415) Other 14,822 -- 152,429 ---------- 825,244 (86,426) 5,366,591 ---------- NET LOSS $ (2,920,183) $ (2,096,951) $(22,062,447) ========== Basic and diluted net loss per share attributable to common stockholders $ (0.15) $ (0.15) ========== Weighted average number of common shares outstanding 19,551,501 14,037,341 ========== ---------- SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. F-3 ---------- AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- Balance, January 31, 1984 (Inception) -- $ -- $ -- $ -- $ -- $ -- Common stock issued for cash at $1 per share 22,000 22 26,502 -- -- 26,524 Common stock issued for cash at $23 per share 1,100 1 24,999 -- -- 25,000 Common stock issued for cash at $86 per share 700 1 59,999 -- -- 60,000 Common stock issued for cash at $94 per share 160 1 14,999 -- -- 15,000 Common stock issued for cash at $74 per share 540 1 39,999 -- -- 40,000 Common stock issued for cash at $250 per share 4,678 5 1,169,495 -- -- 1,169,500 Capital contributions -- -- 521,439 -- -- 521,439 Common stock issued for compensation at $103 per share 2,600 3 267,403 -- -- 267,406 Conversion of due to related parties to common stock at $101 per share 1,120 1 113,574 -- -- 113,575 Conversion of due to related parties to common stock at $250 per share 1,741 2 435,092 -- -- 435,094 Effect of reorganization 2,560,361 2,558 (2,558) -- -- -- Common stock issued in connection with employment contract at $8 per share 65,000 65 519,935 -- -- 520,000 Common stock issued in connection with the acquisition of patents at $8 per share 12,500 13 99,987 -- -- 100,000 Warrants issued to note holders in connection with notes payable -- -- 734,826 -- -- 734,826 Warrants issued for services -- -- 5,000 -- -- 5,000 Net loss -- -- -- -- (4,746,416) (4,746,416) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE, MARCH 31, 2000 2,672,500 2,673 4,030,691 -- (4,746,416) (713,052) Common stock and options issued in connection with acquisition of Cell Activation, Inc. at $7.20 per share 99,152 99 1,067,768 -- -- 1,067,867 Warrants issued to note holders in connection with notes payable -- -- 218,779 -- -- 218,779 Warrants issued to promoter in connection with notes payable -- -- 298,319 -- -- 298,319 Beneficial conversion feature of convertible notes payable -- -- 150,000 -- -- 150,000 Warrants issued to promoter in connection with convertible notes payable -- -- 299,106 -- -- 299,106 Options issued to directors for services as board members -- -- 14,163 -- -- 14,163 ---------- SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-4

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- Options and warrants issued for services -- -- 505,400 -- -- 505,400 Common stock issued for services at $3 per share 5,500 5 16,495 -- -- 16,500 Common stock issued for cash at $1 per share 100,000 100 99,900 -- -- 100,000 Net loss -- -- -- -- (4,423,073) (4,423,073) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE, MARCH 31, 2001 2,877,152 $ 2,877 $ 6,700,621 $ -- $ (9,169,489) $ (2,465,991) Common stock, warrants and options issued for accounts payable and accrued liabilities 21,750 22 243,353 -- -- 243,375 Common stock issued for services at $2.65 per share 6,038 6 15,994 -- -- 16,000 Common stock issued for cash at $1.00 per share, net of issuance costs of $41,540 paid to a related party 730,804 731 688,533 -- -- 689,264 Common stock issued for services at $2.75 per share 10,000 10 27,490 -- -- 27,500 Common stock issued in connection with license agreement at $3.00 per share 6,000 6 17,994 -- -- 18,000 Common stock issued to holder of convertible notes payable at $3.00 per share 70,586 71 211,687 -- -- 211,758 Options issued to directors for services as board members -- -- 7,459 -- -- 7,459 Common stock issued for cash at $1.50 per share, net of issuance costs of $2,500 16,667 17 22,483 -- -- 22,500 Beneficial conversion feature of convertible notes payable -- -- 185,000 -- -- 185,000 Common stock issued for conversion of convertible notes payable and accrued interest at an average price of $1.24 per share 134,165 134 166,352 -- -- 166,486 Common stock issued for services at $2.72 per share 9,651 10 26,240 -- -- 26,250 Options issued to consultant for services -- -- 562,000 -- -- 562,000 Common stock and warrants for services at $1.95 per share 62,327 62 161,475 -- -- 161,537 Common stock issued for services at $1.90 per share 9,198 9 17,491 -- -- 17,500 Stock options exercised for cash 400,000 400 199,600 -- -- 200,000 Warrants issued to note holders for 90-day forebearance -- -- 118,000 -- -- 118,000 Common stock and warrants issued to note holders and vendors in the debt-to-equity conversion program at $1.25 per share 816,359 816 1,623,635 -- -- 1,624,451 Other warrant transactions -- -- (32,715) -- -- (32,715) Net loss -- -- -- --

(3,995,910) (3,995,910) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2002 5,170,697 $ 5,171 $ 10,962,692 $ -- $(13,165,399) $ (2,197,536)
---------- SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-5

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2002 5,170,697 $ 5,171 $ 10,962,692 $ -- $(13,165,399) $ (2,197,536) Proceeds from the issuance of common stock at $0.50 per share in connection with the exercise of options 200,000 200 99,800 -- -- 100,000 Interest expense related to beneficial conversion feature -- -- 150,000 -- -- 150,000 Pro-rata value assigned to warrants issued in connection with conversion of accounts payable -- -- 71,000 -- -- 71,000 Pro-rata value assigned to warrants issued in connection with note payable -- -- 30,000 -- -- 30,000 Issuance of common stock at $1.25 per share in connection with the conversion of accounts payable 150,124 150 187,505 -- -- 187,655 Issuance of common stock at $1.25 per share in connection with the conversion of notes payable 420,000 420 104,580 -- -- 105,000 Estimated fair market value of options issued for services -- -- 114,000 -- -- 114,000 Issuance of common stock at $0.25 per share for cash 461,600 462 114,938 -- -- 115,400 Issuance of common stock at $0.26 per share for cash 19,230 19 4,981 -- -- 5,000 Issuance of common stock at $1.25 per share for cash 8,000 8 9,992 -- -- 10,000 Issuance of common stock at $0.65 per share for services 69,231 69 44,931 -- -- 45,000 Issuance of common stock at $0.51 per share for services 196,078 196 99,804 -- -- 100,000 Adjustment booked -- -- (100,000) -- 100,000 -- Net loss -- -- -- -- (2,461,116) (2,461,116) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2003 6,694,960 $ 6,695 $ 11,894,223 $ -- $(15,526,515) $ (3,625,597)
---------- SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-6

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2003 6,694,960 $ 6,695 $ 11,894,223 $ -- $(15,526,515) $ (3,625,597) Proceeds from the issuance of common stock at $0.25 per share in connection with the exercise of warrants 540,000 540 134,460 -- -- 135,000 Issuance of common stock at $0.25 per share in connection with the conversion of notes payable, including interest of $15,099 300,397 300 74,799 -- -- 75,099 Issuance of common stock at $0.35 per share in connection with the conversion of notes payable, including interest of $59,827 813,790 814 284,013 -- -- 284,827 Issuance of common stock at $0.50 per share in connection with the conversion of notes payable, including interest of $509 11,017 11 5,498 -- -- 5,509 Issuance of common stock at $0.42 per share in connection with the conversion of notes payable, including interest of $696 13,725 14 5,682 -- -- 5,696 Issuance of common stock at $0.65 per share in connection with the conversion of notes payable, including interest of $5,088 27,059 27 17,561 -- -- 17,588 Issuance of common stock at $0.25 per share in connection with the conversion of notes payable, including interest of $15,416 461,667 462 114,954 -- -- 115,416 Issuance of common stock at $0.25 per share for cash 1,226,000 1,226 305,274 -- -- 306,500 Issuance of common stock at $0.30 per share for cash 180,000 180 53,820 -- -- 54,000 Issuance of common stock at $0.525 per share for cash 40,000 40 20,960 -- -- 21,000 Issuance of common stock at $1.125 per share for cash 5,000 5 5,620 -- -- 5,625 Issuance of common stock at $0.25 per share for services 10,000 10 2,490 -- -- 2,500 Issuance of common stock at $0.34 per share for services 73,529 73 24,927 -- -- 25,000 Issuance of common stock at $0.40 per

share for services 62,000 62 24,763 -- -- 24,825 Issuance of common stock at $0.45 per share for services 185,185 185 83,148 -- -- 83,333 Issuance of common stock at $0.50 per share for services 5,000 5 2,495 -- -- 2,500 Interest expense related to beneficial conversion feature -- -- 324,800 -- -- 324,800 Net loss -- -- -- -- (1,518,798) (1,518,798) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2004 10,649,329 $ 10,649 $ 13,379,487 $ -- $(17,045,313) $ (3,655,177)

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-7

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2004 10,649,329 $ 10,649 $ 13,379,487 $ -- $(17,045,313) $ (3,655,177) Proceeds from the issuance of common stock at $0.25 per share in connection with the exercise of warrants 1,126,564 1,127 280,515 -- -- 281,642 Issuance of common stock at $0.44 per share for cash 1,415,909 1,416 621,584 -- -- 623,000 Issuance of common stock at $0.25 per share for cash 40,233 40 9,960 -- -- 10,000 Issuance of common stock at $0.28 per share for cash 35,947 36 9,964 -- -- 10,000 Issuance of common stock at $0.29 per share for cash 69,431 69 19,931 -- -- 20,000 Issuance of common stock at $0.32 per share for cash 94,449 94 29,906 -- -- 30,000 Issuance of common stock at $0.33 per share for cash 60,620 61 19,939 -- -- 20,000 Issuance of common stock at $0.35 per share for cash 172,824 173 59,826 -- -- 59,999 Issuance of common stock at $0.36 per share for cash 223,756 224 79,776 -- -- 80,000 Issuance of common stock at $0.37 per share for cash 108,079 108 39,892 -- -- 40,000 Issuance of common stock at $0.38 per share for cash 26,549 27 9,973 -- -- 10,000 Issuance of common stock at $0.39 per share for cash 51,748 52 19,948 -- -- 20,000 Issuance of common stock at $0.40 per share for cash 25,233 25 9,975 -- -- 10,000 Issuance of common stock at $0.42 per share for cash 143,885 144 59,857 -- -- 60,001 Issuance of common stock at $0.43 per share for cash 70,467 70 29,930 -- -- 30,001 Issuance of common stock at $0.45 per share for cash 22,455 22 9,978 -- -- 10,000 Issuance of common stock at $0.46 per share for cash 43,944 44 19,956 -- -- 20,000 Issuance of common stock at $0.47 per share for cash 128,836 129 59,872 -- -- 60,001 Issuance of common stock at $0.52 per share for cash 95,502 96 49,904 -- -- 49,999 Issuance of common stock with warrants at $0.36 per unit for cash 55,556 56 19,944 -- -- 20,000 Issuance of common stock at $0.27 per share for cash 90,000 90 24,210 -- -- 24,300 Issuance of common stock at $0.50 per share for cash 3,000 3 1,497 -- -- 1,500 Issuance of common stock to Fusion Capital for "commitment" shares 50,000 50 (50) -- -- --

---

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-8

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- Issuance of common stock to Fusion Capital for fees 418,604 419 (419) -- -- (0) Issuance of common stock at $0.34 per share in connection with the conversion of notes payable, including interest of $38,371 479,513 480 162,891 -- -- 163,371 Issuance of common stock at $0.44 per share in connection with the conversion of notes payable 113,636 114 49,886 -- -- 50,000 Issuance of common stock at $0.25 per share in connection with the conversion of notes payable 80,000 80 19,920 -- -- 20,000 Issuance of common stock at $0.49 per share in connection with the conversion of notes payable 174,606 175 85,382 -- -- 85,557 Issuance of common stock at $1.75 per share for services 17,143 17 29,983 -- -- 30,000 Issuance of common stock at $0.44 per share for services 265,273 265 116,455 -- -- 116,720 Issuance of

common stock at $0.70 per share for services 10,715 11 7,489 -- -- 7,500 Issuance of common stock at $0.73 per share for services 6,850 7 4,993 -- -- 5,000 Issuance of common stock at $0.55 per share for services 46,364 46 25,454 -- -- 25,500 Issuance of common stock at $0.25 per share for services 165,492 165 41,208 -- -- 41,373 Issuance of common stock at $0.45 per share for services 28,377 28 12,741 -- -- 12,769 Issuance of common stock at $0.50 per share for services for deferred consulting services 60,000 60 29,940 (30,000) -- -- Issuance of common stock at $0.49 per share for services 25,087 25 12,318 -- -- 12,343 Issuance of common stock at $0.45 per share for services for deferred consulting services 66,666 67 29,933 (30,000) -- -- Issuance of common stock at $0.37 per share for services 13,369 13 4,987 -- -- 5,000 Issuance of common stock at $0.42 per share for services 19,231 19 7,981 -- -- 8,000 Issuance of common stock at $0.39 per share for services 18,042 18 6,982 -- -- 7,000 Issuance of common stock at $0.32 per share for services 162,678 163 52,382 -- -- 52,545 Issuance of common stock at $0.31 per share for services 16,234 16 4,984 -- -- 5,000 Issuance of common stock at $0.39 per share for employee bonus 22,500 22 8,754 -- -- 8,776

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-9

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- Debt discount on debt issued with detachable warrants -- -- 84,000 -- -- 84,000 Amortization of deferred consulting fees -- -- -- 30,000 -- 30,000 Intrinsic value of options issued to directors -- -- 424,262 -- -- 424,262 Net loss -- -- -- -- (2,096,951) (2,096,951) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2005 17,014,696 $ 17,015 $ 16,088,278 $ (30,000) $(19,142,264) $ (3,066,971) Issuance of common stock at $0.28 per share for cash 35,947 36 9,964 -- -- 10,000 Issuance of common stock at $0.26 per share for cash 38,256 38 9,962 -- -- 10,000 Issuance of common stock at $0.26 per share for cash 38,401 38 9,962 -- -- 10,000 Issuance of common stock at $0.25 per share for cash 201,165 201 49,799 -- -- 50,000 Issuance of common stock at $0.25 per share for cash 80,466 80 19,920 -- -- 20,000 Issuance of common stock at $0.25 per share for cash 80,466 80 19,920 -- -- 20,000 Issuance of common stock at $0.25 per share for cash 80,466 80 19,920 -- -- 20,000 Issuance of common stock at $0.25 per share for cash 80,466 80 19,920 -- -- 20,000 Issuance of common stock at $0.18 per share for cash 100,000 100 17,500 -- -- 17,600 Issuance of common stock at $0.25 per Share for cash 301,744 302 74,698 -- -- 75,000 Issuance of common stock at varied prices for cash 2,485,249 2,485 767,512 -- -- 769,997 Issuance of common stock at $0.76 per share for cash 568,181 568 431,249 -- -- 431,818 Issuance of common stock at $0.25 per share in connection with the conversion of notes payable, including interest of $4,564 140,000 140 34,860 -- -- 35,000 Issuance of common stock at $0.20 per share in connection with the conversion of convertible notes payable, including interest of $4,943 174,716 175 34,768 -- -- 34,943 Issuance of common stock at $0.31 per share for services 9,740 10 2,990 -- -- 3,000 Issuance of common stock at $0.30 per share for services 25,134 25 7,475 -- -- 7,500 Issuance of common stock at $0.25 per share for services 31,424 31 7,869 -- -- 7,900 Issuance of common stock at $0.26 per share for services 19,084 19 4,981 -- -- 5,000

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-10

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ---------- Issuance of common stock at $0.25 per share for services 33,228 33 8,407 -- -- 8,440 Issuance of common stock at

$0.25 per share for services 24,000 24 5,976 -- -- 6,000 Issuance of common stock at $0.26 per share for services 11,450 11 2,989 -- -- 3,000 Issuance of common stock at $0.26 per share for services 19,084 19 4,981 -- -- 5,000 Issuance of common stock at $0.26 per share for services 34,352 34 8,966 -- -- 9,000 Issuance of common stock at $0.26 per share for services 11,450 11 2,989 -- -- 3,000 Loss on settlement of accrued legal liabilities -- -- 142,245 -- -- 142,245 Issuance of common stock at $0.24 per share for services 12,605 13 2,987 -- -- 3,000 Issuance of common stock at $0.24 per share for services 21,008 21 4,979 -- -- 5,000 Issuance of common stock at $0.23 per share for services 21,739 22 4,978 -- -- 5,000 Issuance of common stock at $0.23 per share for services 21,740 22 4,978 -- -- 5,000 Issuance of common stock at $0.23 per share for services 2,155 2 498 -- -- 500 Issuance of common stock at $0.23 per share for services 91,739 92 21,008 -- -- 21,100 Issuance of common stock at $0.21 per share for services 175,755 176 37,084 -- -- 37,260 Issuance of common stock at $0.23 per share for services 37,863 38 8,519 -- -- 8,557 Issuance of common stock at $0.23 per share for services 21,368 21 4,979 -- -- 5,000 Issuance of common stock at $0.21 per share for services 27,852 28 5,710 -- -- 5,738 Issuance of common stock at $0.24 per share for services 21,186 21 4,979 -- -- 5,000 Issuance of common stock at $0.22 per share for services 35,278 35 7,585 -- -- 7,620 Issuance of common stock at $0.38 per share for services 13,298 13 4,987 -- -- 5,000 Issuance of common stock at $0.38 per share for services 19,948 20 7,640 -- -- 7,660 Issuance of common stock at $0.37 per share for services 97,662 98 36,037 -- -- 36,135 Issuance of common stock at $0.25 per share for services 371,847 372 91,137 -- -- 91,509 Issuance of common stock at $0.25 per share for services 73,964 74 18,128 -- -- 18,202

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-11

AETHLON MEDICAL, INC. (A Development Stage Company) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (CONTINUED) FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006

DEFICIT ACCUMULATED TOTAL COMMON STOCK ADDITIONAL DEFERRED DURING STOCKHOLDERS' ---------- PAID IN CONSULTING DEVELOPMENT EQUITY SHARES AMOUNT CAPITAL FEES STAGE (DEFICIT) ---------- ---------- ---------- ---------- ---------- ----------

Issuance of common stock at $0.29 per share for services 13,333 13 3,827 -- -- 3,840 Issuance of common stock at $0.33 per share for services 15,060 15 4,985 -- -- 5,000 Issuance of common stock at $0.24 per share for services 579,813 580 138,575 -- -- 139,155 Issuance of common stock at $0.28 and $0.33 per share for services 66,017 66 19,934 -- -- 20,000 Issuance of common stock at $0.36 per share for services 13,889 14 4,986 -- -- 5,000 Issuance of common stock at $0.33 per share for services 9,091 9 2,989 -- -- 2,999 Issuance of common stock at $0.28 per share for services 10,563 11 2,991 -- -- 3,001 Issuance of common stock at $0.33 per share for services 150,000 150 48,850 (49,000) -- -- Issuance of common stock at $0.28 per share for services 35,714 36 9,964 -- -- 10,000 Issuance of common stock at $0.33 per share for services 15,152 15 4,985 -- -- 5,000 Issuance of common stock at $0.28 per per share for services 17,730 18 4,982 -- -- 5,000 Issuance of common stock at $0.20 and $0.37 per share for services 79,255 79 19,894 -- -- 19,974 Issuance of common stock at $0.33 per share for services 33,333 33 9,967 -- -- 10,000 Issuance of common stock at $0.39 per share for services 220,080 220 85,171 -- -- 85,391 Issuance of common stock at $0.49 per share for services 7,275 7 3,543 -- -- 3,550 Issuance of common stock at $0.34 per share for services 27,284 27 9,170 -- -- 9,197 Issuance of common stock at $0.33 per share for services 158,046 158 51,997 -- -- 52,155 Issuance of common stock at $0.20 per share for services 836,730 837 166,509 -- -- 167,346 Issuance of cashless warrants 389,168 389 (389) -- -- -- Conversion of accrued salaries to employee stock options -- -- 300,000 -- -- 300,000 Debt discount on debt issued with detachable warrants -- -- 119,610 -- -- 119,610 Interest expense related to beneficial conversion feature -- -- 222,375 -- -- 222,375 Professional fees related to registration statement -- -- (76,732) -- -- (76,732) Amortization of deferred consulting fees -- -- -- 34,083 -- 34,083 Reclassification of derivative liabilities upon registration of shares underlying warrants -- -- 1,090,000 -- -- 1,090,000 Net loss -- -- -- -- (2,920,183) (2,920,183) ---------- ---------- ---------- ---------- ---------- ---------- BALANCE - MARCH 31, 2006 25,383,705 $ 25,384 $ 20,322,494 $ (44,917) $(22,062,447) $ (1,759,486) ========== ========== ========== ========== ========== ==========

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. F-12

---------- AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006
---------- January 31, 1984 (Inception) Through 2006 2005 March 31, 2006 ---------- Cash flows from operating activities: Net loss $ (2,920,183) $ (2,096,951) $(22,062,447) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation and amortization 34,241 39,836 983,993 Amortization of deferred consulting fees 34,083 30,000 64,083 Gain on settlement of debt (131,175) -- (131,175) Loss on settlement of accrued legal liabilities 142,245 -- 142,245 Gain on sale of property and equipment -- -- (13,065) Change in estimated fair value of warrant liability 360,125 -- 360,125 Fair market value of warrants issued in connection with accounts payable and debt related costs -- -- 2,715,736 Fair market value of common stock, warrants and options issued for services and interest 704,383 339,027 3,212,002 Intrinsic value of stock options issued to directors -- 424,262 424,262 Amortization of debt discount 259,416 38,809 1,108,025 Beneficial conversion feature of convertible notes payable -- -- 334,304 Impairment of patents and patents pending 81,722 -- 978,949 Impairment of goodwill -- -- 217,223 Changes in operating assets and liabilities: Prepaid expenses (22,034) (4,606) 129,315 Other assets 20,050 (16,845) (17,200) Accounts payable and accrued liabilities (118,276) (206,943) 1,513,950 Due to related parties (28,878) (105,955) 1,472,125 ---------- Net cash used in operating activities (1,584,281) (1,559,366) (8,567,550) ---------- Cash flows from investing activities: Purchases of property and equipment (4,651) (30,070) (248,887) Patents and patents pending (11,000) -- (363,833) Proceeds from the sale of property and equipment -- -- 17,065 Cash of acquired company -- -- 10,728
---------- Net cash used in investing activities (15,651) (30,070) (584,927)

---------- SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. continued..... F-13
---------- AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED MARCH 31, 2006 AND 2005 AND FOR THE PERIOD JANUARY 31, 1984 (INCEPTION) THROUGH MARCH 31, 2006 (CONTINUED)
---------- January 31, 1984 (Inception) Through 2006 2005 March 31, 2006 ---------- Cash flows from financing activities: Net proceeds from the issuance of notes payable 100,000 130,000 1,710,000 Principal repayments of notes payable (80,000) (22,500) (292,500) Proceeds from the issuance of convertible notes payable 1,030,000 -- 2,028,000 Net proceeds from the issuance of common stock 1,454,415 1,488,942 6,620,085 Professional fees related to registration statements (76,731) -- (76,731) ---------- Net cash provided by financing activities 2,427,684 1,596,442 9,988,854 ---------- Net increase in cash 827,752 7,006 836,377 Cash at beginning of period 8,625 1,619 -- ---------- Cash at end of period $ 836,377 $ 8,625 $ 836,377 ========== Supplemental disclosure of cash flow information - Cash paid during the period for: Interest $ 8,000 $ 34,766 $ 263,258 ========== Income taxes $ -- $ -- $ 13,346 ========== Supplement schedule of noncash investing and financing activities: Debt and accrued interest converted to common stock $ 69,942 $ 318,925 $ 2,436,961 ========== Debt discount on notes payable associated with detachable warrants $ 1,070,860 $ 84,000 $ 1,154,860 ========== Issuance of common stock, warrants and options in settlement of accrued expenses and due to related parties $ 467,346 $ -- $ 980,162 ========== Reclassification of derivative liability to additional paid in capital $ 1,090,000 $ -- $ 1,090,000 ========== Issuance of common stock in connection with license agreements $ -- $ -- $ 18,000 ========== Net assets of entities acquired in exchange for equity securities $ -- $ -- $ 1,597,867

========== Debt placement fees paid by issuance of warrants $ -- $ -- $ 843,538 ========== Patent pending acquired for 12,500 shares of common stock $ -- $ -- $ 100,000 ========== Common stock issued for prepaid expenses $ -- $ -- $ 161,537 ==========

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS. F-14 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES ORGANIZATION Aethlon Medical, Inc. ("Aethlon") engages in the research and development of a medical device known as the Hemopurifier(TM) that removes harmful substances from the blood. Aethlon is in the development stage on the Hemopurifier(TM) 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") or the regulatory agency of any foreign country where it intends to sell its device. Aethlon has not yet begun efforts to obtain any FDA approval, which may take several years, but it intends to initiate human trials in India to obtain regulatory approval there. Since many of Aethlon's patents were issued in the 1980's, some have expired and other are scheduled to expire in the near future. Thus, some patents may expire before FDA approval or approval in a foreign country, if any, is obtained. However, the Company believes that certain patent applications and/or other patents issued more recently will help protect the proprietary nature of the Hemopurifier(TM) treatment technology. Aethlon 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 planned principal operations. Aethlon's common stock is quoted on the Over-the-Counter Bulletin Board administered by the National Association of Securities Dealers ("OTCBB") under the symbol "AEMD.OB." PRINCIPLES OF CONSOLIDATION The accompanying consolidated financial statements include the accounts of Aethlon Medical, Inc. and its inactive wholly-owned subsidiaries Aethlon, Inc., Hemex, Inc., Syngen Research, Inc. and Cell Activation, Inc.(hereinafter collectively referred to as the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation. GOING CONCERN The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates, among other things, the realization of assets and satisfaction of liabilities in the ordinary course of business. The Company has suffered continuing losses from operations, is in default on certain debt (see Notes 6 and 7), has negative working capital of approximately $1,921,000, recurring losses from operations and a deficit accumulated during the development stage of approximately $22,062,000 at March 31, 2006, which among other matters, raises substantial doubt about its ability to continue as a going concern. 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, 2006. Therefore, the Company will be required to seek additional funds to finance its long-term operations. The Company is currently addressing its liquidity issue by continually seeking investment capital through the public markets, specifically, through private placement of common stock and a common stock purchase agreement with Fusion Capital Fund II, LLC ("Fusion"). As of June 15, 2006, provided certain terms of the agreement remain in force, the Company can sell Fusion up to $4,314,999 of the Company's common stock through June 2007. The Company believes that its cash on hand and the funds available from the common stock purchase agreement with Fusion will be sufficient to meet its liquidity needs for fiscal 2007. However, no assurance can be given that the Company will receive any funds in addition to the funds it has received to date. F-15 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006

---

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) GOING CONCERN (continued) Under such agreement and there is no guarantee that these strategies will enable the Company to meet its obligations for the foreseeable future. The successful outcome of future activities cannot be determined at this time and there is no assurance that, if

achieved, the Company will have sufficient funds to execute its intended business plan or generate positive operating results. The consolidated financial statements do not include any adjustments related to recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern. RISKS AND UNCERTAINTIES The Company operates in an industry that is subject to intense competition, government regulation and rapid technological change. The Company's operations are subject to significant risk and uncertainties including financial, operational, technological, regulatory and other risks associated with a development stage company, including the potential risk of business failure. USE OF ESTIMATES The Company prepares its consolidated financial statements in conformity with GAAP, which requires management to make 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 and reported amounts of revenues and expenses during the reporting periods. Significant estimates made by management include, among others, realization of long-lived assets, valuation of derivative liabilities, estimating fair value associated with debt and equity transactions and valuation of deferred tax assets. Actual results could differ from those estimates. FAIR VALUE OF FINANCIAL INSTRUMENTS Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosure About Fair Value of Financial Instruments," requires disclosure of fair value information about financial instruments when it is practicable to estimate that value. The carrying amount of the Company's cash, accounts payable, accrued liabilities and notes payable approximates their estimated fair values due to the short-term maturities of those financial instruments. . Management has concluded that it is not practical to determine the estimated fair value of amounts due to related parties. SFAS No. 107 requires that for instruments for which it is not practicable to estimate their fair value, information pertinent to those instruments be disclosed, such as the carrying amount, interest rate, and maturity, as well as the reasons why it is not practicable to estimate fair value. Information about these related party instruments is included in Note 9. Management believes it is not practical to estimate the fair value of such financial instruments because the transactions cannot be assumed to have been consummated at arm's length, the terms are not deemed to be market terms, there are no quoted values available for these instruments, and an independent valuation would not be practicable due to the lack of data regarding similar instruments, if any, and the associated potential costs. CONCENTRATIONS OF CREDIT RISKS Cash is maintained at various financial institutions. The Federal Deposit Insurance Corporation ("FDIC") insures accounts at each institution for up to $100,000. At times, cash may be in excess of the FDIC insurance limit. The Company had no amounts exceeding this limit at March 31, 2006. F-16 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) PROPERTY AND EQUIPMENT Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets, which range from two to five years. Repairs and maintenance are charged to expense as incurred while improvements are capitalized. Upon the sale or retirement of property and equipment, the accounts are relieved of the cost and the related accumulated depreciation with any gain or loss included in the statements of operations. INCOME TAXES Under SFAS 109, "Accounting for Income Taxes," deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences 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 carry-forwards. The Company records a valuation allowance for deferred tax assets when, based on management's best estimate of taxable income in the foreseeable future, it is more likely than not that some portion of the deferred income tax assets may not be realized. LONG-LIVED ASSETS 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 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, 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. The provisions of this pronouncement relating to assets held for disposal generally are required to be applied prospectively after the adoption date to newly initiated commitments to sell or dispose of such assets, (as defined), by management. As a result, management cannot determine the potential effects that adoption of SFAS 144 will have on the Company's financial statements with respect to future disposal decisions, if any. Management noted certain impairment indicators requiring review for impairment during the year ended March 31, 2006 and recorded an impairment loss on patents totaling $81,722. EARNINGS PER SHARE Under SFAS 128, "Earnings per Share," basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares assumed to be outstanding during the period of computation. Diluted earnings per share is computed similar to basic earnings 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 (If the Company had net income in each of the years ended March 31, 2006 and 2005, approximately 6,800,000 and 2,100,000 shares would have been considered additional common stock equivalents, respectively, based on the treasury stock method). As the Company had net losses for the periods presented, basic and diluted loss per share are the same, as any additional common stock equivalents would be antidilutive. F-17 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) SEGMENTS SFAS 131, "Disclosure About Segments of an Enterprise and Related Information," requires public companies to report selected segment information in their quarterly reports issued to shareholders. It also requires entity-wide disclosures about the products and services an entity provides, the foreign countries in which it holds significant assets and how the Company reports revenues and its major customers. The Company currently operates in one segment, as disclosed in the accompanying consolidated statements of operations. STOCK BASED COMPENSATION The Company accounts for stock-based compensation issued to employees using the intrinsic value based method as prescribed by Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock issued to Employees." Under the intrinsic value based method, compensation expense is the excess, if any, of the estimated fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period. SFAS 123, "Accounting for Stock-Based Compensation," changed the method of accounting for employee stock-based compensation plans to the fair value based method. For stock options and warrants, fair value is estimated using an option pricing model that takes into account the stock price at the measurement date, the exercise price, the expected life of the option or warrant, stock volatility and the annual rate of quarterly dividends, if any. The adoption of the accounting methodology of SFAS 123 is optional and the Company has elected to continue account for stock-based compensation issued to employees using APB 25; however, pro forma disclosures, as if the Company had adopted the cost recognition requirement under SFAS 123, are required to be presented (see below). Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB 25" clarifies the application of APB 25 for (a) the definition of employee for purpose of applying APB 25, (b) the criteria for determining whether a plan qualifies as a non compensatory plan, (c) the accounting consequence for various modifications to the terms of a previously fixed stock option or award and (d) the accounting for an exchange of stock compensation awards in a business combination. Management believes that the Company accounts for transactions involving stock-based employee compensation in accordance with FIN 44. SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an Amendment of FASB Statement No. 123," provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. F-18 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) STOCK BASED COMPENSATION (continued) At March 31, 2006, the Company has one stock-based employee compensation plan (the "Plan"), which is described more fully in Note 8. The Company accounts for the Plan under the recognition and measurement principles of APB 25, and

related interpretation. Stock options granted under the Plan had exercise prices equal to or greater than the estimated fair value of the underlying common stock on the dates of grant. In February 2005, the Company granted 5,303,275 stock options to directors for past services, all at an exercise price that was $0.08 below the estimated fair value of the underlying common stock on the date of grant. Accordingly, the Company recorded approximately $424,000 of compensation expense in the accompanying consolidated statement of operations for the year ended March 31, 2005. The following table illustrates the effect on net loss and loss per common share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation. YEAR ENDED MARCH 31, ---------- 2006 2005 ---------- ---------- Net loss available to common stockholders, as reported $ 2,920,183 $ 2,096,951 Add back: Recorded intrinsic value -- (424,262) Pro forma compensation expense 361,111 2,386,474 ---------- ---------- Pro forma net loss available to common stockholders $ 3,281,294 $ 4,059,163 ========== ========== Loss per common share, as reported Basic and diluted $ (0.15) $ (0.15) Loss per common share, pro forma Basic and diluted $ (0.17) $ (0.29) The Company follows SFAS No. 123 (as intepreted by 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") to account for transactions involving services provided by third parties where the Company issues equity instruments as part of the total consideration. Pursuant to paragraph 8 of SFAS No. 123, 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 Issue 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) 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. F-19 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) STOCK BASED COMPENSATION (continued) In December 2004, the FASB issued SFAS No. 123 (R), "Share-Based Payments," which requires that the compensation cost relating to share-based payment transactions (including the cost of all employee stock options) be recognized in the financial statements. That cost will be measured based on the estimated fair value of the equity or liability instruments issued. SFAS No. 123 (R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS No.123 (R) replaces SFAS No. 123 and supersedes APB 25. As originally issued, SFAS No. 123 established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that pronouncement permitted entities to continue applying the intrinsic-value model of APB 25, provided that the financial statements disclosed the pro forma net income or loss based on the preferable fair-value method. The Company is required to apply SFAS No. 123 (R) in the first interim or annual reporting period of the registrant's first fiscal year that begins after December 15, 2005. Thus, the Company's consolidated financial statements will reflect an expense for (a) all share-based compensation arrangements granted on or after April 1, 2006 and for any such arrangements that are modified, cancelled, or repurchased on or after that date, and (b) the portion of previous share-based awards for which the requisite service has not been rendered as of that date, based on the grant-date estimated fair value. Management has not yet determined the future effect of SFAS 123 (R) on its consolidated financial statements. SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion 29, Accounting for Nonmonetary Transactions". The amendments made by SFAS No. 153 are based on the principle that exchanges of nonmonetary assets should be measured using the estimated fair value of the assets exchanged. SFAS No. 153 eliminates the narrow exception for nonmonetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has "commercial substance" if the future cash flows of the entity are expected to change significantly as a result of the transaction. This

pronouncement is effective for nonmonetary exchanges in fiscal periods beginning after June 15, 2005. The adoption of this pronouncement is not expected to have a material impact on the Company's consolidated financial statements. In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," which replaces APB Opinion No. 20, "Accounting Changes" and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements." This pronouncement applies to all voluntary changes in accounting principle, and revises the requirements for accounting for and reporting a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable to do so. This pronouncement also requires that a change in the method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS No. 154 retains many provisions of APB Opinion No. 20 without change, including those related to reporting a change in accounting estimate, a change in the reporting entity, and correction of an error. The pronouncement also carries forward the provisions of FASB No. 3 which govern reporting accounting changes in interim financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS No. 154. The adoption of this pronouncement is not expected to have a material impact on the Company's future consolidated financial statements. F-20 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006
---------- 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS (continued) In February 2006, the FASB issued SFAS No. 155 entitled "Accounting for Certain Hybrid Financial Instruments," an amendment of SFAS No. 133 ("Accounting for Derivative Instruments and Hedging Activities") and SFAS No. 140 ("Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"). In this context, a hybrid financial instrument refers to certain derivatives embedded in other financial instruments. SFAS No. 155 permits fair value re-measurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation under SFAS No. 133. SFAS No. 155 also establishes a requirement to evaluate interests in securitized financial assets in order to identify interests that are either freestanding derivatives or "hybrids" which contain an embedded derivative requiring bifurcation. In addition, SFAS No. 155 clarifies which interest/principal strips are subject to SFAS No. 133, and provides that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS No. 155 amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative. When SFAS No. 155 is adopted, any difference between the total carrying amount of the components of a bifurcated hybrid financial instrument and the fair value of the combined "hybrid" must be recognized as a cumulative-effect adjustment of beginning deficit/retained earnings. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year, provided that the entity has not yet issued any annual or interim financial statements for such year. Restatement of prior periods is prohibited. The Company has not determined the impact of SFAS No. 155 on its future consolidated financial statements. 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. PATENTS The Company capitalizes the cost of patents and patents pending, 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. STOCK PURCHASE WARRANTS ISSUED WITH NOTES PAYABLE The Company granted warrants in connection with the issuance of certain notes payable (see Notes 6, 7 and 8). Under Accounting Principles Board Opinion No. 14, "Accounting for Convertible Debt and Debt Issued With Stock Purchase Warrants", as amended, the relative estimated fair value of such warrants represents a discount from the face amount of the notes payable. Accordingly, the relative estimated fair value of the warrants in those certain transactions where the warrants qualified for equity classification has been recorded in the consolidated financial statements as a discount from the face amount of the notes. The discount is amortized using the effective yield method over the respective term of the related notes payable. F-21 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO

CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued) BENEFICIAL CONVERSION FEATURE OF CONVERTIBLE NOTES PAYABLE The convertible feature of certain notes payable (see Notes 6 and 7) provides for a rate of conversion that is below market value. Such feature is normally characterized as a "beneficial conversion feature" ("BCF"). Pursuant to Emerging Issues Task Force Issue No. 98-5 ("EITF Issue No. 98-5"), "Accounting for Convertible Securities With Beneficial Conversion Features or Contingently Adjustable Conversion Ratio" and Emerging Issues Task Force Issue No. 00-27, "Application of EITF Issue No. 98-5 to Certain Convertible Instruments," the estimated fair value of the BCF is recorded in the consolidated financial statements as a discount from the face amount of the notes. Such discounts are amortized to interest expense over the term of the notes using the effective yield method. The Company has determined the unamortized fair value of such BCF to be approximately $127,761 and $0 for the years ended March 31, 2006 and 2005, respectively. CLASSIFICATION OF WARRANT OBLIGATION In connection with the issuance of the 10% Series A Convertible Notes (see Note 7), the Company had an obligation to file a registration statement covering the common shares underlying the convertible notes and related warrants (the "Registrable Securities", as defined in the Registration Rights Agreement). The obligation to file the registration statement met the criteria of an embedded derivative to be bifurcated pursuant to SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended. Additionally, the Company was required to classify the warrant obligation as a derivative liability, recorded at its fair value, in accordance with SFAS No. 133 under EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed To, and Potentially Settled In, a Company's Own Stock." The classification of the warrant obligation was evaluated at each reporting date and until such time a registration statement which includes the shares underlying the warrants became effective, with changes in fair value included in earnings. RESEARCH AND DEVELOPMENT EXPENSES The Company incurred approximately $754,000 and $497,000 of research and development expenses during the years ended March 31, 2006 and 2005, respectively, which are included in various operating expenses in the accompanying consolidated statements of operations. OFF-BALANCE SHEET ARRANGEMENTS The Company has not entered into any off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on the Company's financial statements. RECLASSIFICATIONS Certain reclassifications have been made to the 2005 financial statement presentation to Correspond to the 2006 presentation. 2. PROPERTY AND EQUIPMENT Property and equipment consist of the following at March 31, 2006: Furniture and office equipment $ 243,724 Accumulated depreciation (231,346) ---------- $ 12,378 ========== Depreciation expense for the years ended March 31, 2006 and 2005 approximated $23,000 and $16,000, respectively. F-22 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 3. PATENTS Patents include both foreign and domestic patents. There was one patent pending at March 31, 2006 and 2005. The unamortized cost of patents and patents pending is written off when management determines there is no future benefit. During the years ended March 31, 2006 and 2005, patents with net carrying values of $81,722 and $0, respectively, were written off as impairment expense. At March 31, 2006, the gross carrying amount of patents and the related accumulated amortization approximated $157,000 and $26,000, respectively. Amortization of patents approximated $12,000 and $23,000 during the years ended March 31, 2006 and 2005, respectively. Amortization expense on patents is estimated to be approximately $9,000 per year for the next five fiscal years. Some of the Company's patents have expired and others may expire before FDA approval, if any, is obtained. 4. OTHER ASSETS Other assets consist of deposits at March 31, 2006. 5. DEBT-TO-EQUITY CONVERSION PROGRAM In March 2002, for a limited time, the Company extended an offer to certain note holders and vendors to convert past due amounts into restricted common stock and warrants to purchase common stock of the Company. The offer entailed the conversion of liabilities at a rate of one share and one-half of a warrant for every $1.25 converted. The warrants had an exercise price of $2.00 per share and expired three years from the date of issuance; none are outstanding at March 31, 2006 and 2005. 6. NOTES PAYABLE 12% NOTES From August 1999 through September 2000, the Company entered into arrangements for the issuance of notes payable from private placement offerings (the "12% Notes") in the original aggregate amount of $422,500. The 12% Notes bore annual interest at 12% (15% after maturity), required interest to be paid quarterly, matured one year from the date of issuance, and carried detachable warrants. These notes have no acceleration provisions. In June 2004, one such note in the principal amount of $12,500 plus accrued interest was repaid. In

December 2004, each of two such notes in the principal amount of $25,000, plus $17,778 accrued interest, were converted to 87,303 restricted common shares at $0.49 per share. On May 27, 2005 the Company issued a promissory note to an accredited investor in an amount of $100,000 with 12% interest maturing on December 1, 2005. In conjunction with the issuance of the Note, the Company also issued a 12-month warrant to acquire 400,000 shares of Common Stock at $0.25 per share. Accordingly, this warrant has been valued using a Black-Scholes option pricing model and an associated discount of $41,860, was accreted to interest expense over the term of the Note. This entire amount was included in interest expense during the fiscal year ended March 31, 2006. At March 31, 2006, $372,500 of principal balance of the 12% Notes were outstanding and delinquent, in default, and bore interest at the default rate of 15%. F-23 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006

---------- 6. NOTES PAYABLE (continued) 10% NOTES In October 2004, the Company issued two $40,000, 10% one-year promissory notes (the "10% Notes") each with 80,000 three-year warrants to purchase common stock at $0.50 per share and 44,444 three-year warrants to purchase common stock at $0.90 per share for cash in the total amount of $80,000 to two accredited individual investors. In accordance with GAAP, the proceeds of the financing have been allocated to the debt and the warrants, based on their relative fair values. Accordingly, a discount of $46,000 has been recorded as a reduction in the debt blance, and the off-setting credit has been recorded as additional paid-in capital. The debt discount is amortized and charged to interest expense over the life of the debt. During each of the fiscal year ended March 31, 2006 and 2005, the Company amortized approximately $23,000 to interest expense. The entire principal balance of the 10% Notes totaling $80,000, and associated accrued interest of $8,000, were repaid in October 2005. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In October 2004, the Company issued a $50,000, 10% one-year promissory note plus 100,000 three-year warrants to purchase common stock at $0.50 per share and 55,555 three-year warrants to purchase common stock at $0.90 per share for cash in the amount of $50,000 to an accredited individual investor. In accordance with GAAP, the proceeds of the financing were allocated to the debt and the warrants in fiscal 2005, based on their relative fair values. Accordingly, a discount of $38,000 was recorded as a reduction in the debt balance, and the off-setting credit was recorded as additional paid-in capital. The debt discount is being amortized and charged to interest expense over the term of the debt. During the year ended March 31, 2006 and 2005, the Company amortized approximately $22,000 and $16,000 to interest expense, respectively. During the year ended March 31, 2005, $20,000 in principal amount of this note was reduced through application of the note to exercise a portion of the warrants. On March 23, 2006 the Company issued 140,000 restricted shares of common stock in exchange for the remaining $30,000 principal balance and approximately $4,600 of accrued interest associated with this note. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. From time to time, the Company issued convertible notes payable ("10% Note") to various investors, bearing interest at 10% per annum, with principal and interest due six months from the date of issuance. The 10% Notes require no payment of principal or interest during the term and may be converted to common stock of the Company at the conversion price of $0.50 per share at any time at the option of the noteholder. The total amount of the original notes issued was $275,000. There were two remaining 10% Notes outstanding at March 31, 2004. As of such date and through March 31, 2006, these notes were classified as notes payable since they were no longer convertible. In July 2004, the Company repaid one of the two remaining 10% Note in the principal amount of $10,000, plus accrued interest. This note was classified as notes payable as of March 31, 2004 since the note was no longer convertible at such time. The remaining 10% Note in the amount of $5,000, was past due and in default at March 31, 2006. At March 31, 2006, interest payable on this note totaled $2,375. 9% NOTE In April 2003, the Company issued a convertible note in the amount of $150,000 ("9% Note"), bearing interest at 9% per annum, with principal and interest due in June 2003, which is in default and currently bears penalty interest at 18% per annum. The 9% Note required no payment of principal or interest during the term and was convertible into common stock of the Company at the conversion price of $0.25 per share through June 2003 at the option of the noteholder. As this note is no longer convertible, the outstanding balance totaling $150,000 has been recorded as notes payable in the accompanying consolidated balance sheet. Notes payable, which are all in default, consist of the following at March 31, 2006: 12% Notes payable, all past due $372,500 10% Note payable, past due 5,000 9% Note payable, past due 150,000 -------- $527,500 ======== Management's plans to satisfy the remaining outstanding balance on these notes include converting the notes to common stock at market value or repayment with available funds. 7. CONVERTIBLE NOTES PAYABLE 8% CONVERTIBLE NOTE In

November 2000, the Company issued convertible notes payable ("8% Convertible Notes") with original issue amounts totaling $395,000, bearing interest at 8% per annum, with principal and accrued interest due on November 1, 2002. F-24 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 7. CONVERTIBLE NOTES PAYABLE (continued) 8% CONVERTIBLE NOTE (continued) The 8% Convertible Notes required the Company to file an effective registration statement by February 2001. The Company filed a Form SB-2 with the SEC in December 2000; however, such registration statement was never declared effective and was subsequently abandoned. However, as the underlying securities are no longer restricted under Rule 144 of the Securities Act of 1933, the Company no longer plans on filing a registration statement in connection with this transaction. The Company accrued and expensed penalties approximating $244,000 through March 31, 2004 in connection with not filing an effective registration statement. During the year ended March 31, 2005 it was discovered that the penalties did not have to be paid. Accordingly, such amount was reversed in fiscal 2005 and is included as a credit to interest expense in the accompanying consolidated statements of operations. There was one remaining 8% Convertible Note with an outstanding principal balance of $125,000 at March 31, 2004. This note balance, including accrued interest of $38,370, was converted in September 2004 to 479,513 shares of common stock 15% CONVERTIBLE NOTE On May 16, 2005 the Company issued Fusion Capital ("Fusion") a $30,000 Convertible Promissory Note (the "Convertible Note") with an interest rate of fifteen percent (15%) per annum that matured on August 15, 2005 (the "Maturity Date"). In addition, the Company issued Fusion a five-year warrant to purchase 300,000 shares of the Company's common stock at an exercise price of $0.25 per share (the "Warrant"). In accordance with EITF Issue No. 98-5, EITF Issue No. 00-27 and APB No. 14, the Company recorded debt discounts associated with conversion feature and the warrants totaling $30,000 which was entirely amortized to interest expense during the fiscal year ended March 31, 2006. The Convertible Note and approximately $5,000 in associated accrued interest was exchanged for 174,716 shares of restricted common stock on March 23, 2006. 10% SERIES A CONVERTIBLE NOTES From July 11, 2005 through December 15, 2005 the Company received cash investments totaling $1,000,000 from accredited investors based on agreed-upon terms reached on the cash receipt dates. Such investments were documented in November and December 2005 in several 10% Series A Convertible Notes. The 10% Series A Convertible Notes accrue interest at a rate of ten percent (10%) per annum and mature on January 2, 2007. The 10% Series A Convertible Notes are convertible into shares of common stock at any time at the election of the holder at a conversion price equal to $0.20 per share for any conversion occurring on or prior to the maturity date. In addition, upon conversion, the Company is obligated to issue three-year Warrants (the "Series A Warrants") to purchase a number of shares equal to the number of shares into which the Series A Notes can be converted at an exercise price of $0.20. The Conversion Option SFAS No. 133 states that a contract issued by an entity that is both (a) indexed to its own stock and (b) would be classified in stockholders' equity if it were a freestanding financial instrument is not a derivative for purposes of that pronouncement. Management has concluded that the conversion option associated with the 10% Series A Convertible Notes is "indexed to the Company's own stock" as that term is defined by EITF Issue No. 01-6, "The Meaning of Indexed to Company's Own Stock". In addition, since such notes have been determined to be "conventional convertible debt instruments" as defined in EITF Issue No. 05-2, "The Meaning of Conventional Convertible Debt Instrument" in Issue 00-19", the requirements of EITF Issue No. 00-19 do not apply. Lastly, the debt host contract is not a derivative in its entirety and (based on SFAS No. 133) the conversion option need not be bifurcated from such contract. Therefore, the conversion option is not a derivative instrument as contemplated by EITF Issue No. 00-19 or SFAS No. 133. As explained below, the Company has therefore applied intrinsic value accounting to the BCF embedded in the conversion option. Intrinsic Value Accounting for the BCF The Company has accounted for the BCF associated with the 10% Series A Convertible Notes in accordance EITF Issue No. 98-5, EITF Issue No. 00-27, and APB No. 14. The convertible feature of the 10% Series A Convertible Notes provides for a rate of conversion that is below market value. The excess of the proceeds over the estimated fair value of the warrants (see "Accounting for the Warrants" below) was used to calculate the effective conversion price per share. Pursuant to EITF 98-5 and EITF 00-27, the Company has estimated the fair value of such BCF to be $270,125 and recorded such amount as a debt discount against the face amount of the notes. Such discount is being accreted to interest expense over the term of the notes. Total interest expense on the 10% Series A Convertible Notes for amortization of the above BCF debt discount totaled $142,365 for the fiscal year ended March 31, 2006. F-25 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31,

2006 ---------- 7. CONVERTIBLE NOTES PAYABLE (continued) 10% SERIES A CONVERTIBLE NOTES (continued) Accounting for the Warrants Under this transaction, the Company is obligated to register for resale the common shares underlying the warrants, and as a result, the embedded derivative associated with this warrant obligation does not meet the scope exception of paragraph 11(a) of SFAS No. 133. Specifically, at the commitment date, the Company did not have any uncommitted registered shares to settle the warrant obligation and accordingly, such obligation was required to be classified as a liability (outside of stockholders' deficit) in accordance with EITF Issue No. 00-19. The Series A Warrants were valued at $729,875 on the commitment date using a Binomial Lattice option pricing model. Such amount was recorded as a derivative liability and an offsetting debt discount against the face amount of the 10% Series A Convertible Notes. Such debt discount will be expensed as future conversions occur. On January, 2006, the registration statement which included the shares underlying the 10% Series A Convertible Notes and related warrants was deemed effective. Accordingly, the Company revalued the warrants at such date, totaling $1,090,000, with the change in fair value of the warrant liability totaling $360,125 expensed in the accompanying consolidated statements of operations for the year ended March 31, 2006. If the effectiveness of the registration statement is not maintained, the Company could incur liquidated damages as described in the related registration rights agreement. 8. EQUITY TRANSACTIONS 2003 CONSULTANT STOCK PLAN In August 2003, the Company adopted the 2003 Consultant Stock Plan (the "Stock Plan"), which provides for grants of common stock through August 2013, to assist the Company in obtaining and retaining the services of persons providing consulting services for the Company. A total of 1,000,000 common shares are reserved for issuance under the Stock Plan. On March 29, 2004, the Company filed a registration statement on Form S-8 for the purpose of registering 1,000,000 common shares issuable under the Stock Plan under the Securities Act of 1933. On August 29, 2005, the Company filed a Form S-8 for the purpose of registering an additional 2,000,000 shares, for a total of 3,000,000 common shares reserved under the Plan. 2005 DIRECTORS COMPENSATION PROGRAM In February 2005, the Company adopted the 2005 Directors Compensation Program (the "Directors Compensation Program") to assist in obtaining and retaining the services of outside directors. Under the Directors Compensation Program, a newly elected director will receive a one time grant of a non-qualified stock option of 1.5% of the common stock outstanding at the time of election. The options will vest one-third at the time of election to the board and the remaining two-thirds will vest equally at year end over three years. Additionally, each director will also receive an annual $25,000 non-qualified stock option retainer, $15,000 of which is to be paid at the first of the year to all directors who are on the Board prior to the first meeting of the year and a $10,000 retainer will be paid if a director attends 75% of the meetings either in person, via conference call or other electronic means. The exercise price for the options under the Directors Compensation Program will equal the average closing of the last ten (10) trading days prior to the date earned. F-26 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) COMMON STOCK In April 2004, the Company issued 500,000 shares of restricted common stock to an accredited individual investor in connection with the exercise of warrants at $0.25 per share for cash totaling $125,000. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In April 2004, the Company issued 17,143 shares at $1.75 per share to an accredited individual investor for investor relations services in the amount of $30,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In April 2004, the Company issued 50,000 shares of restricted common stock to Fusion Capital Fund II, LLC, an accredited institutional investor, for a financing commitment to provide $6,000,000 under a registered private placement. In connection with the $6,000,000 financing the Company paid a fee to Fusion Capital in the amount of 418,604 shares of common stock. The Company recorded no expense related to the issuance of these shares since they were related to equity fund raising activities. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In May 2004, the Company issued 225,000 shares of common stock at $0.44 per share and 225,000 warrants to purchase the Company's common stock at a price of $0.76 per share to legal counsel for legal services in the amount of $99,000, which was recorded as expense in the accompanying consolidated financial statements. This transaction was exempt from registration pursuant to Section 4(2)of the Securities Act of 1933. In May 2004, a $50,000 10% convertible note was converted at $0.44 per share for 113,636 shares of common stock and 113,636 warrants to purchase the Company's common stock at a price of $0.76 per share. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In

May 2004, the Company issued a total of 1,415,909 shares of restricted stock at a price of $0.44 per share for cash totaling $623,000 to fourteen accredited investors. In connection with the issuance of these shares, the Company granted the stockholders 1,640,908 warrants to purchase the Company's common stock at a price of $0.76 per share. The warrants vested immediately and expire on the fifth anniversary from the date when a registration statement covering the common stock underlying such warrants is declared effective. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. In July 2004, the Company issued 10,715 shares of restricted common stock at $0.70 per share to an accredited individual for employee placement services in the amount of $7,500. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In July 2004, the Company issued 6,850 shares of restricted common stock at $0.73 per share to an accredited individual for consulting services on opportunities for the Company's Hemopurifier(TM) within the biodefense marketplace in the amount of $5,000. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In September 2004, the Company issued 479,513 shares of restricted common stock to an accredited investor, in conjunction with the conversion of $125,000 in principal amount of notes, plus accrued interest, at $0.34 per share, in accordance with their convertible note agreement (see Note 7). This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. F-27 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) COMMON STOCK (continued) In November and December 2004, the Company issued 80,000 shares of restricted common stock to an accredited individual investor in connection with the exercise of 80,000 warrants at $0.25 per share for consideration of a $20,000 reduction in the principal amount of a 10% one-year promissory note. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In December 2004, the Company issued 461,667 shares of restricted common stock to two accredited individual investors in connection with the exercise of 461,667 warrants at $0.25 per share for cash totaling $115,417. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In December 2004, the Company repaid two $25,000 12% promissory notes, including accrued interest of $17,778 each, through the issuance of 87,303 restricted common shares at $0.49 per share to each of two separate accredited individual investors. These transactions were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In December 2004, the Company issued 60,000 shares of restricted common stock at $0.50 per share under a consulting agreement with an accredited individual investor, for investor relations consulting services to the Company. The fair value of the transaction of $30,000 was recorded as deferred compensation and presented as an offset to additional paid-in capital in the accompanying consolidated financial statements. Such amount is being amortized to expense over the six month term of the agreement. At March 31, 2005, $15,000 of such amount remained unamortized. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. The remaining $15,000 balance in deferred consulting fees were amortized during the fiscal year ended March 31, 2006. In January 2005, the Company issued 55,556 shares of restricted common stock at $0.36 per share and a warrant to purchase 55,556 shares of common stock at $0.44 per share for cash in the amount of $20,000 to an accredited individual investor. This transaction was exempt from registration pursuant to Section 4(2)of the Securities Act of 1933. In January 2005, the Company issued 66,666 shares of restricted common stock at $0.45 per share to an accredited individual investor under a consulting agreement for investor relations services to the Company. The fair value of the transaction of $30,000 was recorded as deferred compensation and presented as an offset to additional paid-in capital in the accompanying consolidated financial statements. Such amount is being amortized to expense over the six month term of the agreement. At March 31, 2005, $15,000 of such amount remained unamortized. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. The remaining $15,000 balance in deferred consulting fees were amortized during the fiscal year ended March 31, 2006. In January 2005, the Company issued 25,834 shares of restricted common stock to an accredited individual investor in connection with the exercise of a warrant to purchase 25,834 shares of common stock at $0.25 per share for cash totaling $6,459. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In February 2005, the Company issued 139,063 shares of restricted common stock to an accredited individual investor in connection with the exercise of a warrant to purchase 139,063 shares of common stock at $0.25 per share for cash totaling $34,766. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. F-28 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED

FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) COMMON STOCK (continued) In February 2005, the Company issued 90,000 shares of restricted common stock at $0.27 per share and a three-year warrant to purchase 90,000 shares of common stock at $0.34 per share for cash in the amount of $24,300 to an accredited individual investor. This transaction was exempt from registration pursuant to Section 4(2)of the Securities Act of 1933. During the year ended March 31, 2005, the Company issued an additional total of 1,416,958 shares of restricted common stock at prices ranging from $0.25 to $0.52 for total cash proceeds of approximately $541,000. During the year ended March 31, 2005, the Company issued an additional 557,647 shares of restricted common stock at prices ranging from $0.25 to $0.55 under various consulting service agreements for total recorded value of approximately $196,000. All services on these agreements were completed and expensed during the year ended March 31, 2005. In April 2005, the Company issued 9,740 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.31 per share in payment for scientific consulting services to the Company valued at $3,000. In April 2005, the Company issued 25,134 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.30 per share in payment for regulatory affairs consulting services to the Company valued at $7,500. In April 2005, the Company issued 31,424 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.25 per share in payment for regulatory affairs consulting services to the Company valued at $7,900. During the year ended March 31, 2006, the Company issued 3,990,807 shares of common stock at prices between $0.25 to and $0.76 per share to Fusion Capital under its $6,000,000 common stock purchase agreement for cash proceeds totaling $1,436,815. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004. During the quarter ended June 30, 2005, the Company issued 95,420 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.262 per share in payment for regulatory affairs consulting services to the Company valued at $25,000. In May 2005, the Company issued 33,228 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.25 per share in payment for regulatory affairs consulting services to the Company valued at $8,440. In May 2005, the Company issued 24,000 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.25 per share in payment for investor relations consulting services to the Company valued at $6,000. In May 2005 the Company issued 100,000 shares of common stock and a warrant to purchase 400,000 shares of common stock at a purchase price of $0.18 per share to an accredited investor for $17,600. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933. F-29 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) COMMON STOCK (continued) In May 2005, the Company issued 11,450 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.26 per share in payment for scientific consulting services to the Company valued at $3,000. In June 2005, the Company issued 34,352 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.26 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In June 2005, the Company issued 34,352 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.26 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In June 2005, the Company issued 11,450 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.26 per share in payment for scientific consulting services to the Company valued at $3,000. In June 2005, the Company issued 21,008 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.24 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In June 2005, the Company issued 836,730 shares of restricted common stock and a three-year warrant to purchase 418,365 shares of the Company's restricted common stock at an exercise price of $0.25 to legal counsel as an inducement to settle accrued past due legal services payable in the amount of $167,346 which had been expensed in the prior fiscal year. At the time of the settlement, the shares of the Company's restricted common stock were valued at $209,183 and, using a Black-Scholes option pricing model, the warrant was valued at $100,408. The non-cash additional consideration of $142,245 has been recorded as professional

fees expense during the fiscal year ended March 31, 2006. In June 2005, the Company issued 12,605 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 scientific consulting services to the Company valued at $3,000. During the quarter ended June 30, 2005, the Company expensed $30,000 of deferred consulting fees, which were included in additional paid-in capital at March 31, 2005, as the related consulting services were completed. In July 2005, the Company issued 43,479 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.23 per share in payment for regulatory affairs consulting services to the Company valued at $10,000. In July 2005, the Company issued 2,155 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.23 per share in payment for regulatory affairs consulting services to the Company valued at $500. In August 2005, the Company issued 37,863 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.23 per share in payment for regulatory affairs consulting services to the Company valued at $8,557. F-30 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006

---

8. EQUITY TRANSACTIONS (continued)

COMMON STOCK (continued) In August 2005, the Company issued 91,739 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.23 per share in payment for regulatory affairs consulting services to the Company valued at $21,100. In August 2005, the Company issued 21,368 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.23 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In August 2005, the Company issued 175,755 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.21 per share in payment for regulatory affairs consulting services to the Company valued at $37,260. In September 2005, the Company issued 27,852 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.21 per share in payment for regulatory affairs consulting services to the Company valued at $5,738. In October 2005, the Company issued 21,186 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.24 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In October 2005, the Company issued 35,278 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.22 per share in payment for regulatory affairs consulting services to the Company valued at $7,620. In November 2005, the Company issued 19,948 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.38 per share in payment for regulatory affairs consulting services to the Company valued at $7,660. In November 2005, the Company issued 97,662 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.37 per share in payment for regulatory affairs consulting services to the Company valued at $36,135. In November 2005, the Company issued 13,298 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.38 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In December 2005, the Company issued 371,847 shares of common stock to legal counsel pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.25 per share in payment of general legal fees valued at $91,509. In December 2005, the Company issued 73,964 shares of restricted common stock at $0.25 per share in payment of legal fees related to capital raising transactions valued at $18,202. F-31 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006

---

8. EQUITY TRANSACTIONS (continued)

COMMON STOCK (continued) In December 2005, the Company issued 13,333 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.29 per share in payment for regulatory affairs consulting services to the Company valued at $3,840. In December 2005, the Company issued 15,060 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.33 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In January 2006, the Company issued 579,813 shares of restricted common stock at $0.24 per share in payment for patent fees valued at $139,155. In January 2006, the Company issued 66,017 shares of restricted

common stock at Prices ranging from $0.28 to $0.33 per share in payment for investor relations valued at $20,000. In January 2006, the Company issued 9,091 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.33 per share in payment for regulatory affairs consulting services to the Company valued at $3,000. In January 2006, the Company issued 13,889 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.36 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In February 2006, the Company issued 10,563 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.28 per share in payment for regulatory affairs consulting services to the Company valued at $3,000. In March 2006, the Company issued 17,730 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.28 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In March 2006, the Company issued 79,255 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.28 per share in payment for Corporate communications consulting services to the Company valued at $19,974. In March 2006, the Company issued 110,040 shares of common stock to legal counsel pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan and 110,040 shares of restricted stock at $0.39 per share in payment of general legal fees valued at $85,392. In March 2006, the Company issued 7,275 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 affairs consulting services to the Company. In March 2006, the Company issued 27,284 shares of common stock to legal counsel pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.34 per share in payment of general legal fees valued at $9,197. F-32 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) COMMON STOCK (continued) In March 2006, the Company issued 158,046 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consultant Stock Plan at $0.33 per share in payment for regulatory affairs consulting services to the Company valued at $52,155. In March 2006, the Company converted a $30,000 10% promissory notes held by an accredited individual investor, including accrued interest of $4,564, through the issuance of 140,000 restricted common shares at $0.25 per share. In March 2006, a $30,000 15% convertible note, including accrued interest of $4,943, was converted at $0.20 per share for 174,716 shares of common stock. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. In March 2006, the Company issued 150,000 shares of restricted common stock under a one year investor relations consulting agreement which was valued at $49,000 and being amortized over a one year period. Approximately $4,000 was amortized during the year ended March 31, 2006. As a result, the remaining balance of $44,917 represents that entire balance of deferred consulting fees (contra equity) in accompanying consolidated balance sheet. In March 2006, the Company issued 35,714 shares of restricted common stock payment of professional services related to investor relations valued at $10,000. In March 2006, the Company issued 15,152 shares of restricted common stock at $0.33 per share in payment of professional services related to investor relations valued at $5,000. In March 2006, the Company issued 33,333 shares of restricted common stock at $0.30 per share in payment of an option agreement valued at $10,000. WARRANTS During the year ended March 31, 2005, the Company granted 568,181 warrants to an investor in connection with a commitment fee for the purchase of common stock. The warrants have an exercise price of $0.76 per share, vest immediately and are exercisable through May 2009. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements. During the year ended March 31, 2005, the Company granted 847,727 warrants to investors in connection with the purchase of common stock. The warrants have an exercise price of $0.76 per share, vest immediately and are exercisable through May 2009. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements. During the year ended March 31, 2005, the Company issued 113,636 warrants to purchase common stock for $0.76 per share, which are exercisable through May 2009 and vested upon grant. The warrants were issued in connection with the conversion of notes payable (see Notes 7 and 8). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata estimated fair value was insignificant and was charged to interest expense upon grant. During the year ended March 31, 2005, the Company issued 225,000 warrants to purchase common stock for $0.76 per share, which are exercisable through May

2009 and vested upon grant. The warrants were issued in connection with common stock issued for legal services expense totaling $99,000 (see "Common Stock" above). F-33 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) WARRANTS (continued) During the year ended March 31, 2005, the Company issued 260,000 warrants to purchase common stock for $0.50 per share, which vested upon grant and expire in October 2007. The warrants were issued in connection with the issuance of notes payable (see Note 7). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata estimated fair value is being amortized to interest expense over the life of the notes. During the year ended March 31, 2005, the Company issued 144,443 warrants to purchase common stock for $0.90 per share, which vested upon grant and expire in October 2007. The warrants were issued in connection with the issuance of notes payable (see Note 7). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata estimated fair value was amortized to interest expense over the life of the notes. During the year ended March 31, 2005, the Company granted 55,556 warrants to An investor in connection with the purchase of common stock. The warrants have an exercise price of $0.44 per share, vest immediately and are exercisable through January 2008. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements. During the year ended March 31, 2005, the Company granted 90,000 warrants to investors in connection with the purchase of common stock. The warrants have an exercise price of $0.34 per share, vest immediately and are exercisable through February 2008. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements. As noted under "Common Stock", 1,206,564 warrants with an exercise price of $0.25 per share, which were granted to investors in connection with the purchase of common stock, were exercised during the year ended March 31, 2005. On May 16, 2005, the Company granted 100,000 warrants to an accredited investor in connection with the purchase of 100,000 restricted common shares for $17,600. the warrants have an exercise price of $0.176 and are exercisable through May 2008. On May 16, 2005, the Company granted 300,000 warrants to Fusion Capital Fund II, LLC in connection with the issuance of a 15% Convertible Note. The warrants have an exercise price of $0.25 per share and are exercisable through May 2010. On May 27, 2005, the Company granted 400,000 warrants to an accredited investor in connection with the issuance of a $100,000 12% note payable. The warrants had an exercise price of $0.25 and expired on May 27, 2006. On June 27, 2005, the Company granted three-year warrants to purchase 418,365 shares of the Company's restricted common stock at an exercise price of $0.25 to legal counsel as an inducement to settle accrued past due legal services payable. From July 11, 2006 through December 14, 2005, the Company granted three-year warrants to purchase 5,000,000 shares of common stock to the holders of an aggregate of $1,000,000 in 10% Series A Convertible Notes. The warrants have an exercise price of $0.20 and will be issued upon conversion of the underlying 10% Series A Convertible Notes. On March 31, 2006, as an inducement to exercise 568,181 warrants at an exercise price of $0.76 per share, the Company issued five-year replacement warrants in like amount to Fusion Capital Fund II, LLC. The 568,181 replacement warrants have an exercise price of $0.76. Such warrants were valued using Binomial Option Pricing model and such vale was insignificant. F-34 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) WARRANTS (continued) A summary of the aggregate warrant activity for the years ended March 31, 2006 and 2005 is presented below: Year Ended March 31, ---------- 2006 2005 ---------- ---------- Weighted Weighted Average Exercise Average Exercise Warrants Price Warrants Price ---------- ---------- ---------- ---------- Outstanding, beginning of year 2,833,834 $ 0.91 3,793,194 $ 2.22 Granted 1,786,546 $ 0.41 2,311,543 0.71 Exercised (568,182) $ 0.76 (1,206,564) 0.25 Cancelled/Forfeited (260,291) $ 3.30 (2,064,339) 2.75 ---------- --------- ---------- --------- Outstanding, end of year 3,791,908 $ 0.61 2,833,834 $ 0.91 ========== ========= ========== ========= Exercisable, end of year 3,791,908 $ 0.61 2,833,834 $ 0.91 ========== ========= ========== ========= Weighted average estimated fair value of warrants granted $ 0.23 $ 0.60 ========= ========= The following outlines the significant weighted average assumptions used to estimate the fair value information presented utilizing the Black-Scholes and Binomial Lattice option pricing models: Years Ended March 31, 2006 2005 ---------- ---------- Risk free interest rate 4.18%-4.3% 2.00% Average expected life 3 years 2 years Expected volatility 72% - 97% 139% Expected dividends None None The detail of the warrants outstanding and exercisable as of March 31, 2006 is as follows: Warrants Outstanding

Warrants Exercisable ---------- ---------- Weighted Weighted Weighted Average Average Average Number Remaining Exercise Number Exercise Range of Exercise Prices Outstanding Life (Years) Price Outstanding Price ---------- ---------- ---------- ---------- ---------- ---------- $0.18 - $0.20 100,000 3.00 $ 0.18 100,000 $ 0.18 $0.25 - $0.44 1,443,921 1.76 $ 0.26 1,443,921 $ 0.26 $0.50 - $0.90 2,158,987 3.63 $ 0.74 2,158,987 $ 0.74 $2.75 - $4.00 89,000 0.73 $ 3.79 89,000 $ 3.79 ---------- ---------- 3,791,908 3,791,908 ========== ========== F-35 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) OPTIONS At March 31, 2006 the Company had issued 1,337,825 options to outside directors and 3,965,450 options to employee-directors under the 2005 Directors Compensation Program. 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. In August 2000, the Company adopted the 2000 Stock Option Plan ("Stock Option Plan"), which was approved by its stockholders in September 2000. The Stock Option Plan provides for the issuance of up to 500,000 options to purchase shares of common stock. Such options can be incentive options or nonstatutory options, and may be granted to employees, directors and consultants. The Stock Option Plan has limits as to the eligibility of those stockholders who own more than 10% of Company stock, as defined. The options granted pursuant to the Stock Option Plan may have exercise prices of no less than 100% of fair market value of the Company's common stock at the date of grant (incentive options), or no less than 75% of fair market value of such stock at the date of grant (nonstatutory). At March 31, 2006, the Company had granted 47,500 options under the 2000 Stock Option Plan of which 15,000 had been forfeited, with 467,500 available for future issuance. In March 2002, the Board of Directors granted the Company's Chief Executive Officer ("CEO") and Chief Scientific Officer ("CSO") non-qualified stock options to purchase up to 250,000 shares of common stock each, at an exercise price of $1.90 per share (the estimated fair value of the underlying common stock at grant date) and expire March 2012. Awards are earned upon achievement of certain financial and/or research and development milestones. On July 1, 2005, the Company's CEO forfeited all of his aforementioned 250,000 options. In February 2005, the Board of Directors granted the Company's Chief Executive Officer ("CEO")and Chief Scientific Officer ("CSO") non-qualified stock options to purchase up to 2,231,100 and 1,734,350 shares of common stock, respectively, at an exercise price of $0.38 per share and vest fifty percent immediately, twenty-five percent in December 2005 and twenty-five percent in December 2006. In addition Mr. Calvin Leung, a board member, was granted non-qualified stock options to purchase up to 308,725 shares at $0.38 that vest fifty percent immediately, twenty-five percent in December 2005 and twenty-five percent in December 2006. Messrs. Franklyn S Barry and Edward G Broenniman, board members, were each granted non-qualified stock options to purchase up to 514,550 shares at $0.38 that vest forty percent immediately, twenty-five percent in December 2005 and twenty-five percent in December 2006. All of these options granted expire in 2010 and 2011 and were granted at a price that was $0.08 below the estimated fair value of the underlying common stock on the date of grant. Accordingly, the Company recorded approximately $424,000 of compensation expense in the accompanying consolidated statement of operations for the year ended March 31, 2005. On September 9, 2005, the Company granted 2,857,143 options to James A. Joyce, its Chief Executive Officer, in exchange for $300,000 of accrued related-party liabilities. The fair value of such options approximated the value of the accrued related-party liability. F-36 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 8. EQUITY TRANSACTIONS (continued) OPTIONS (continued) The following is a summary of the stock options outstanding at March 31, 2006 and 2005 and the changes during the two years then ended: Year Ended March 31, ---------- 2006 2005 ---------- ---------- Weighted Weighted Average Average Exercise Exercise Options Price Options Price ---------- ---------- ---------- ---------- Outstanding, beginning of year 6,679,390 $ 0.80 1,376,115 $ 2.49 Granted 3,357,143 0.21 5,303,275 0.38 Exercised -- -- -- -- Cancelled/Forfeited (1,023,748) 2.74 -- -- ---------- ---------- ---------- ---------- Outstanding, end of year 9,012,785 $ 0.38 6,679,390 $ 0.80 ========== ========== ========== ========== Exercisable, end of year 7,135,518 $ 0.39 3,924,856 $ 1.10 ========== ========== ========== ========== Weighted average estimated fair value of options granted $ 0.12 $ 0.45 ========== ========== The following outlines the significant weighted average

assumptions used to estimate the fair value information presented utilizing the Binomial Lattice option pricing model for the years ended March 31, 2006 and March 31, 2005: Years Ended March 31, 2006 2005 ---------- ---------- Risk free interest rate 4.18% 3.75% Average expected life 4.7 years 4 years Expected volatility 72% 225% Expected dividends None None The detail of the options outstanding and exercisable as of March 31, 2006 is as follows: Options Outstanding Options Exercisable ---------- ---------- Weighted Weighted Weighted Average Average Average Number Remaining Exercise Number Exercise Range of Exercise Prices Outstanding Life Price Outstanding Price ---------- ---------- ---------- ---------- --------- $0.21 - $0.23 3,357,143 4.13 years $ 0.21 2,857,143 $ 0.21 $0.38 5,303,275 4.61 years $ 0.38 3,926,008 $ 0.38 $1.78 - $3.75 352,367 5.57 years $ 2.02 352,367 $ 2.02 ---------- ---------- 9,012,785 7,135,518 ========== ========== F-37 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 9. RELATED PARTY TRANSACTIONS DUE TO RELATED PARTIES Certain officers of the Company and other related parties have advanced the Company funds, agreed to defer compensation and/or paid expenses on behalf of the Company to cover working capital deficiencies. These non interest-bearing liabilities have been included as due to related parties in the accompanying consolidated financial statements. Other related party transactions are disclosed elsewhere in these notes to consolidated financial statements. 10. INCOME TAX PROVISION Income tax expense for the years ended March 31, 2006 and 2005 differed from the amounts computed by applying the U.S. Federal income tax rate of 34 percent to the loss from continuing operations before provision for income taxes as a result of the following: 2006 2005 ---------- ---------- Computed "expected" tax benefit $ (993,000) $ (713,000) Reduction in income taxes resulting from: Derivative expense 122,000 -- Change in deferred tax assets valuation allowance 1,024,000 814,000 State and local income taxes, net of federal benefit (153,000) (125,000) Other -- 24,000 ---------- ---------- $ -- $ -- ========== ========== The tax effects of temporary differences that give rise to significant portions of deferred tax assets at March 31, 2006 are presented below: Deferred tax assets: Capitalized research and development $ 2,401,000 Net operating loss carryforwards 4,401,000 Other 136,000 ---------- Total gross deferred tax assets 6,938,000 Less valuation allowance (6,938,000) ---------- Net deferred tax assets $ -- ========== The valuation allowance increased by $1,024,000 and $814,000 during the years ended March 31, 2006 and 2005, respectively. The current provision for income taxes for the years ended March 31, 2006 and 2005 is not significant and due primarily to certain state taxes. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Management considers projected future taxable income and tax planning strategies in making this assessment. Based upon the history of operating losses, management believes it is more likely than not the Company will not realize the benefits of these deductible differences. A full reduction allowance has been recorded to offset 100% of the deferred tax asset. As of March 31, 2006, the Company had tax net operating loss carryforwards of approximately $11,600,000 and $6,300,000 available to offset future taxable Federal and state income, respectively. The carryforward amounts expire in various years through 2026. In the event the Company were to experience a greater than 50% change in ownership as defined in Section 382 of the Internal Revenue Code, the utilization of the Company's tax net operating loss carryforwards could be severely restricted. F-38 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 11. COMMITMENTS AND CONTINGENCIES EMPLOYMENT CONTRACTS The Company entered into an employment agreement with its Chairman of the Board effective April 1, 1999. The agreement, which is cancelable by either party upon sixty days notice, will be in effect until the employee retires or ceases to be employed by the Company. The Chairman of the Board was appointed President and Chief Executive Officer ("CEO") effective June 1, 2001 upon which the base annual salary was increased from $120,000 to $180,000. Effective January 1, 2005, the CEO's salary was increased from $180,000 to $205,000 per year. The CEO is eligible for an annual bonus at the discretion of the Board of Directors, of which $0 and $20,000 was earned during each of the years ended March 31, 2006 and 2005, respectively. Under the terms of the agreement, if the employee is terminated he may become eligible to receive a salary continuation payment in the amount of at least twelve months' base salary. Effective April 1, 2006,the CEO's salary was increased from $205,000 to $240,000 per year. The Company entered into an employment agreement with Dr. Tullis effective January 10, 2000. Effective June 1, 2001, Dr. Tullis was appointed the Company's

Chief Science Officer of the Company. His compensation under the agreement was modified in June 2001 from $80,000 to $150,000 per year. Effective January 1, 2005 Dr. Tullis' salary was increased from $150,000 to $165,000 per year Under the terms of the agreement, his employment continues at a salary of $165,000 per year for successive one-year periods, unless given notice of termination 60 days prior to the anniversary of his employment agreement. Dr. Tullis was granted 250,000 stock options to purchase the Company's common stock in connection the completing certain milestones, such as the initiation and completion of certain clinical trials, the submission of proposals to the FDA and the filing of a patent application. Under the terms of the agreement, if the employee is terminated he may become eligible to receive a salary continuation payment in the amount of twelve months base salary. Effective April 1, 2006, the CSO's salary was increased from $165,000 per year to $185,000 per year. LEASE COMMITMENTS The Company leases its office and research and development space under an operating lease agreement which expires in July 2006. The Company signed a new 12 month extension of its existing lease on substantially the same terms as its present lease. Minimum monthly payments under the new extension approximate $7,700. Rent expense approximated $126,000 and $106,000 for the years ended March 31, 2006 and 2005, respectively. 12. SUBSEQUENT EVENTS (unaudited) In April 2006, the Company issued 3,782 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.79 per share in payment for regulatory affairs consulting services to the Company valued at $3,000. In April 2006, the Company issued 25,601 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.50 per share in payment for past due rents owed by the Company valued at $12,800. In April 2006, the Company issued 6,313 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.79 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. F-39 AETHLON MEDICAL, INC. (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2006 ---------- 12. SUBSEQUENT EVENTS (unaudited) (continued) In April 2006, the Company issued 10,000 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.50 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In April 2006, the Company issued 14,563 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.29 per share in payment for regulatory affairs consulting services to the Company valued at $4,165. In April 2006, the Company issued 3,086 shares of restricted common stock at $0.81 per share in payment for investor relations. During April 2006, the Company issued 209,679 shares of common stock at prices between $0.57 and $0.74 per share to Fusion Capital under its $6,000,000 common stock purchase agreement for cash proceeds totaling $140,002. These shares are registered pursuant to the Company's Form SB-2 registration statement effective December 7, 2004. In April 2006, the Company repaid a $25,000 15% promissory notes, including accrued interest of $18,750, through the issuance of 107,759 restricted common shares at $0.405 per share to an accredited individual investor. In May 2006, the Company issued 8,532 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.59 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In May 2006, the Company issued 5,703 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.53 per share in payment for regulatory affairs consulting services to the Company valued at $3,000. In May 2006, the Company issued 4,545 shares of restricted common stock at $0.55 per share in payment for investor relations. In June 2006, the Company issued 8,681 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.58 per share in payment for regulatory affairs consulting services to the Company valued at $5,000. In June 2006, the Company issued 5,703 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.53 per share in payment for regulatory affairs consulting services to the Company valued at $3,000. In June 2006, the Company issued 3,363 shares of common stock pursuant to the Company's S-8 registration statement covering the Company's 2003 Consulting Stock Plan at $0.45 per share in payment for regulatory affairs consulting services to the Company valued at $1,500. F-40