AETHLON MEDICAL INC
Form 10-Q
February 16, 2012

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

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FORM 10-Q

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

For the quarterly period ended: December 31, 2011

or

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

For the transition period from: _____ to _____

_____

AETHLON MEDICAL, INC.

(Exact name of registrant as specified in its charter)

_____

Nevada	000-21846	13-3632859
(State or Other Jurisdiction of Incorporation or Organization)	(Commission File Number)	(I.R.S. Employer Identification No.)

8910 UNIVERSITY CENTER LANE, SUITE 660, SAN DIEGO, CA 92122
(Address of Principal Executive Offices) (Zip Code)

(858) 459-7800
(Registrant's telephone number, including area code)

_____

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

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

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

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

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

As of February 15, 2012, the registrant had outstanding 111,629,725 shares of common stock, $.001 par value.

PART I. FINANCIAL INFORMATION		
ITEM 1.	FINANCIAL STATEMENTS	
	CONDENSED CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 2011 (UNAUDITED) AND MARCH 31, 2011	3
	CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE AND NINE MONTH PERIODS ENDED DECEMBER 31, 2011 AND 2010 (UNAUDITED)	4
	CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTH PERIODS ENDED DECEMBER 31, 2011 AND 2010 (UNAUDITED)	5
	NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)	7
ITEM 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	26
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	32
ITEM 4.	CONTROLS AND PROCEDURES	22
PART II.	OTHER INFORMATION	33
ITEM 1.	LEGAL PROCEEDINGS	33
ITEM 1A.	RISK FACTORS	33
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	33
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	33
ITEM 4.	MINE SAFETY DISCLOSURES	33
ITEM 5.	OTHER INFORMATION	33
ITEM 6.	EXHIBITS	34

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2011 (Unaudited)	March 31, 2011
ASSETS		
Current assets		
Cash	$354,804	$15,704
Deferred financing costs	193,749	157,732
Accounts receivable	183,367	—
Note receivable	—	200,000
Interest receivable	—	7,096
Prepaid expenses and other current assets	26,250	29,711
Total current assets	758,170	410,243
Property and equipment, net	2,535	7,785
Patents and patents pending, net	133,108	139,981
Deposits	9,210	9,210
Total assets	$903,023	$567,219
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities		
Accounts payable	$634,082	$308,413
Due to related parties	617,570	617,570
Notes payable	584,796	190,000
Convertible notes payable, net of discounts	2,462,825	2,181,852
Derivative liabilities	1,250,705	2,002,896
Accrued liquidated damages	437,800	437,800
Other current liabilities	1,022,436	804,386
Total current liabilities	7,010,214	6,542,917
Commitments and Contingencies (Note 12)		
Stockholders' Deficit		
	108,980	77,469

Common stock, par value $0.001 per share; 250,000,000 shares authorized as of December 31, 2011 and March 31, 2011; 108,977,508 and 77,467,361 shares issued and outstanding as of December 31, 2011 and March 31, 2011, respectively		
Additional paid-in capital	45,869,870	42,418,778
Deficit accumulated	(52,086,041)	(48,471,945)
Total stockholders’ deficit	(6,107,191)	(5,975,698)
Total liabilities and stockholders' deficit	$903,023	$567,219

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three and Nine Month Periods Ended December 31, 2011 and 2010

(Unaudited)

	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010
REVENUES				
Government contract revenue	$958,075	$—	$958,075	$—
OPERATING EXPENSES				
Professional fees	427,419	386,828	1,037,613	889,161
Payroll, consulting and related services	487,959	534,747	1,553,514	2,350,825
General and administrative	384,025	125,126	623,712	378,701
Total operating expenses	1,299,403	1,046,701	3,214,839	3,618,687
OPERATING LOSS	(341,328)	(1,046,701)	(2,256,764)	(3,618,687)
OTHER EXPENSE (INCOME)				
Loss on extinguishment of debt	—	963,018	—	3,189,942
Loss on settlement of accrued interest and damages	—	—	—	68,703
(Gain) on change in fair value of derivative liability	(74,940)	(430,077)	(1,596,442)	(2,098,954)
Interest and other debt expenses	308,386	594,128	2,594,526	3,346,247
Interest income	(56)	(5,599)	(938)	(19,496)
Other	—	(300,000)	360,185	—
Total other expense (income)	233,390	821,470	1,357,331	4,486,442
NET LOSS	$(574,718)	$(1,868,171)	$(3,614,095)	$(8,105,129)
BASIC AND DILUTED LOSS PER COMMON SHARE	$(0.01)	$(0.03)	$(0.04)	$(0.12)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC AND DILUTED	107,061,316	70,918,490	98,202,051	67,991,430

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Month Periods Ended December 31, 2011 and 2010

(Unaudited)

	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010
Cash flows from operating activities:		
Net loss	$(3,614,095)	$(8,105,129)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	13,858	14,301
Stock based compensation	609,503	1,599,915
Loss on debt extinguishment	—	3,189,942
Fair market value of conditional warrants that subsequently were issued	—	74,652
Non cash interest expense	538,736	1,696,055
Fair market value of common stock, warrants and options issued for services	328,327	590,734
Change in fair value of derivative liabilities	(1,596,442)	(2,098,954)
Issuance of note in convertible note termination	360,186	—
Amortization of debt discount and deferred financing costs	1,703,219	1,301,014
Changes in operating assets and liabilities:		
Accounts receivable	(183,367)	—
Prepaid expenses and other assets	10,557	52,260
Accounts payable and other current liabilities	728,432	152,246
Due to related parties	—	20,000
Net cash used in operating activities	(1,101,086)	(1,512,964)
Cash flows from investing activities:		
Purchases of property and equipment	(1,735)	(2,541)
Additions to patents and patents pending	—	(6,805)
Net cash used in investing activities	(1,735)	(9,346)
Cash flows from financing activities:		
Principal repayments of notes payable	(15,000)	—
Net proceeds from the issuance of convertible notes payable	1,256,921	1,105,000
Proceeds from the issuance of common stock	—	283,600
Proceeds from collection of secured notes receivable	200,000	300,000
Net cash provided by financing activities	1,441,921	1,688,600

Net increase in cash	339,100	166,290
Cash at beginning of period	15,704	67,950
Cash at end of period	$354,804	$234,240

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

For the Nine Month Periods Ended December 30, 2011 and 2010

(Unaudited)

	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$3,636	$—
Income taxes	$—	$—
Supplemental disclosures of non-cash investing and financing activities:		
Derivative liabilities recorded in connection with embedded conversion feature of convertible notes and/or warrants	$—	$6,980,347
Debt and accrued interest converted to common stock	$1,812,386	$1,075,550
Debt discount recorded in connection with beneficial conversion feature of convertible notes and related warrants	$1,037,901	$1,708,600
Issuance of convertible notes in settlement of accrued legal fees	—	35,469
Reclassification of warrant derivative liability into equity	$263,689	$—
Issuance of shares in connection with restricted stock grant to officer	$—	$600

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

December 31, 2011

NOTE 1. NATURE OF BUSINESS AND BASIS OF PRESENTATION

Aethlon Medical, Inc. ("Aethlon", the "Company", "we" or "us") is a medical device company focused on creating innovative devices that address unmet medical needs in cancer, infectious disease and other life-threatening conditions. At the core of our developments is the Aethlon ADAPT™ (Adaptive Dialysis-Like Affinity Platform Technology) system, a medical device platform that converges single or multiple affinity drug agents with advanced plasma membrane technology to create therapeutic filtration devices that selectively remove harmful particles from the entire circulatory system without loss of essential blood components. Approval to embark on human trials is still needed to reach commercial viability of the Hemopurifier® and approval by the U.S. Food and Drug Administration ("FDA"). Successful outcomes of human trials will be required by the regulatory agencies of certain foreign countries where we intend to sell this device. We have submitted an Investigational Device Exemption ("IDE") to the FDA. Some of our patents may expire before FDA approval or approval in a foreign country, if any, is obtained. However, we believe that certain patent applications and/or other patents issued more recently will help protect the proprietary nature of the Hemopurifier(R) treatment technology.

In prior periods, Aethlon was classified as a development stage enterprise under accounting principles generally accepted in the United States of America ("GAAP") as it had not generated revenues from its planned principal operations. In the three months ended December 31, 2011, we began to generate revenues from a government contract and have emerged from the development stage. Subsequent to December 31, 2011, we recorded the first commercial shipment of one of our products to a life sciences company for diagnostics use.

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and applicable sections of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments necessary to make the financial statements not misleading have been included. The condensed consolidated balance sheet as of March 31, 2011 was derived from our audited financial statements. Operating results for the nine months ended December 31, 2011 are not necessarily indicative of the results that may be expected for the year ending March 31, 2012. For further information, refer to our Annual Report on Form 10-K for the year ended March 31, 2011, which includes audited financial statements and footnotes as

of March 31, 2011 and for the years ended March 31, 2011 and 2010 and the period January 31, 1984 (Inception) through March 31, 2011.

NOTE 2. LIQUIDITY

The accompanying unaudited condensed consolidated financial statements have been prepared on a going concern basis, which contemplates, among other things, the realization of assets and the satisfaction of liabilities in the ordinary course of business. We have experienced continuing losses from operations, are in default on certain debt, have negative working capital of approximately $6,252,000, recurring losses from operations and an accumulated deficit of approximately $52,086,000 at December 31, 2011, which among other matters, raises significant doubt about our ability to continue as a going concern. We have not generated significant revenue or any profit from operations since inception. A significant amount of additional capital will be necessary to advance the development of our products to the point at which they may become commercially viable. Our current financial resources are insufficient to fund our 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, 2012 ("fiscal 2012"). Therefore we will be required to seek additional funds through debt and/or equity financing arrangements to finance our current and long-term operations.

On September 30, 2011, we entered into a contract with the United States of America, issued by SPAWAR Systems Center Pacific, pursuant to a contract award from the Defense Advanced Research Projects Agency (“DARPA”). Under the DARPA award, we have been engaged to develop a therapeutic device to reduce the incidence of sepsis, a fatal bloodstream infection that often results in the death of combat-injured soldiers. The award from DARPA is a fixed-price contract with potential total payments to us of $6,794,389 over the course of five years, including payments of up to $1,975,047 in the first year. Fixed price contracts require the achievement of multiple, incremental milestones to receive the full award during each year of the contract. Under the terms of the contract, we will perform certain incremental work towards the achievement of specific milestones against which we will invoice the government for fixed payment amounts. Assuming all such work is performed according to the contract terms, we will receive up to $1,975,047 of contract payments during the first twelve months of the contract with the aggregate payment amounts in years two through five varying between approximately $775,000 and $1.6 million per year. DARPA has the option to extend the contract for years two through five. Only the first year of the contract related to the $1,975,047 has been formally entered into as of the date of this Form 10-Q filing. The milestones are comprised of planning, engineering and clinical targets, the achievement of which in some cases will require the participation and contribution of third party participants under the contract. There can be no assurance that we alone, or with third party participants, will meet such milestones to the satisfaction of the government and in compliance with the terms of the contract or that we will be paid the full amount of the contract revenues during any year of the contract term. We commenced work under the contract in October 2011 (See below and Note 12 for additional information regarding revenue recognition).

As of December 31, 2011, we received two initial payments under the DARPA contract totaling $774,708 and billed the government for a third invoice in the amount of $183,367, which is shown as an account receivable on the accompanying balance sheet.

Also during the three months ended December 31, 2011, we raised an additional $384,265 in net proceeds from a bridge financing that may yield up to $1 million in total gross proceeds through the private placement of convertible promissory notes and corresponding warrants with accredited investors (see Note 5 – Convertible Notes for more details of this offering) per the terms of the subscription agreement.

In addition to the funds received to date under the DARPA contract and under the bridge financing and beyond future fundings under the DARPA contract, we will require additional capital as our current financial resources, while improved, remain insufficient to fund our working capital and other cash requirements for the remainder of our fiscal year ending March 31, 2012. Therefore we will be required to seek additional funds through debt and/or equity financing arrangements to finance our current and long-term operations. We are currently addressing our liquidity needs by exploring investment capital opportunities through the private placement of common stock or issuance of additional debt, including the remaining portion of the bridge financing. We believe that our access to additional capital, together with existing cash resources, will be sufficient to meet our short term liquidity needs for fiscal 2012. However, no assurance can be given that we will receive any funds in connection with our capital raising efforts on terms acceptable to the Company, if at all.

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

NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

PRINCIPLES OF CONSOLIDATION

The accompanying condensed consolidated financial statements include the accounts of Aethlon Medical, Inc. and its wholly-owned subsidiary, Exosome Sciences, Inc., (collectively hereinafter referred to as the "Company" or "Aethlon"). There exist no material intercompany transactions or balances between Aethlon and its subsidiary.

LOSS PER COMMON SHARE

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

The potentially dilutive common shares outstanding for at December 31, 2011 and 2010, which include common shares underlying outstanding stock options, warrants and convertible debentures, were 114,215,775 and 81,138,329, respectively.

PATENTS

We capitalize the cost of patents, some of which were acquired, and amortize such costs over their estimated useful life, upon issuance of the patent, not to exceed the patent legal life.

RESEARCH AND DEVELOPMENT EXPENSES

We incurred research and development expenses during the three and nine month periods ended December 31, 2011 and 2010, which are included in various operating expense line items in the accompanying condensed consolidated statements of operations. Our research and development expenses in those periods were as follows:

	December 31, 2011	December 31, 2010
Three months ended	$536,079	$127,918
Nine months ended	$864,443	$317,345

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of the Company's cash, accounts receivable, accounts payable and accrued liabilities approximates their estimated fair values due to the short-term maturities of these financial instruments. The fair value of certain convertible notes and related warrants at December 31, 2011 is $1,250,705 based upon a third party valuation report that we commissioned. Warrants classified as derivative liabilities are reported at their estimated fair value, with changes in fair value being reported in current period results of operations.

Management has concluded that it is not practical to determine the estimated fair value of amounts due to related parties 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.

EQUITY INSTRUMENTS FOR SERVICES PROVIDED BY OTHER THAN EMPLOYEES

We account for transactions involving goods and services provided by third parties where we issue equity instruments as part of the total consideration using the fair value of the consideration received (i.e., the value of the goods or services) or the fair value of the equity instruments issued, whichever is more reliably measurable.

In transactions, when the value of the goods and/or services is not readily determinable and (1) the fair value of the equity instruments is more reliably measurable and (2) the counterparty receives equity instruments in full or partial settlement of the transactions, we use the following methodology:

(a) For transactions where goods have already been delivered or services rendered, the equity instruments are issued on or about the date the performance is complete (and valued on the date of issuance).

(b) For transactions where the instruments are issued on a fully vested, non-forfeitable basis, the equity instruments are valued on or about the date of the contract.

(c) For any transactions not meeting the criteria in (a) or (b) above, we re-measure the consideration at each reporting date based on its then current stock value.

IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS

We review our long-lived assets for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If the cost basis of a long-lived asset is greater than the projected future undiscounted net cash flows from such asset (excluding interest), an impairment loss is recognized. Impairment losses are calculated as the difference between the cost basis of an asset and its estimated fair value. We believe that no impairment occurred at or during the three and nine months ended December 31, 2011 and 2010.

BENEFICIAL CONVERSION FEATURE OF CONVERTIBLE NOTES PAYABLE

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

REVENUE RECOGNITION

With respect to revenue recognition, we entered into a contract with DARPA as discussed above and have recognized revenue during the three months ended December 31, 2011 of $958,075 under such contract. We adopted the Milestone method of revenue recognition for the DARPA contract under ASC 605-28 “Revenue Recognition – Milestone Method” and we believe we meet the requirements under ASC 605-28 for reporting contract revenue under the Milestone Method for the quarter ended December 31, 2011.

In order to account for this contract, the Company identifies the deliverables included within the contract and evaluates which deliverables represent separate units of accounting based on if certain criteria are met, including

whether the delivered element has standalone value to the collaborator. The consideration received is allocated among the separate units of accounting, and the applicable revenue recognition criteria are applied to each of the separate units.

A milestone is an event having all of the following characteristics:

(1) There is substantive uncertainty at the date the arrangement is entered into that the event will be achieved. A vendor's assessment that it expects to achieve a milestone does not necessarily mean that there is not substantive uncertainty associated with achieving the milestone.

(2) The event can only be achieved based in whole or in part on either: (a) the vendor's performance; or (b) a specific outcome resulting from the vendor's performance.

(3) If achieved, the event would result in additional payments being due to the vendor.

A milestone does not include events for which the occurrence is either: (a) contingent solely upon the passage of time; or (b) the result of a counterparty's performance.

The policy for recognizing deliverable consideration contingent upon achievement of a milestone must be applied consistently to similar deliverables.

The assessment of whether a milestone is substantive is performed at the inception of the arrangement. The consideration earned from the achievement of a milestone must meet all of the following for the milestone to be considered substantive:

(1) The consideration is commensurate with either: (a) the vendor's performance to achieve the milestone; or (b) the enhancement of the value of the delivered item or items as a result of a specific outcome resulting from the vendor's performance to achieve the milestone;

(2) The consideration relates solely to past performance; and

(3) The consideration is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

A milestone is not considered substantive if any portion of the associated milestone consideration relates to the remaining deliverables in the unit of accounting (i.e., it does not relate solely to past performance). To recognize the milestone consideration in its entirety as revenue in the period in which the milestone is achieved, the milestone must be substantive in its entirety. Milestone consideration cannot be bifurcated into substantive and nonsubstantive components. In addition, if a portion of the consideration earned from achieving a milestone may be refunded or adjusted based on future performance, the related milestone is not considered substantive.

See Note 12 for the additional disclosure information required under ASC 605-28.

DERIVATIVE LIABILITIES AND CLASSIFICATION

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

The classification of a derivative instrument is reassessed at each balance sheet date. If the classification changes as a result of events during a reporting period, the instrument is reclassified as of the date of the event that caused the reclassification. There is no limit on the number of times a contract may be reclassified.

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

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

REGISTRATION PAYMENT ARRANGEMENTS

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

STOCK-BASED COMPENSATION

Employee stock options and rights to purchase shares under stock participation plans are accounted for under the fair value method. Accordingly, share-based compensation is measured when all granting activities have been completed, generally the grant date, based on the fair value of the award. The exercise price of options is generally equal to the market price of the Company's common stock (defined as the closing price as quoted on the OTCBB) on the date of grant. Compensation cost recognized by the Company includes (a) compensation cost for all equity incentive awards granted prior to, but not yet vested as of April 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of the then current accounting standards, and (b) compensation cost for all equity incentive awards granted subsequent to April 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of subsequent accounting standards. We use a Binomial Lattice option pricing model for estimating fair value of options granted (see Note 10).

INCOME TAXES

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the difference between the consolidated financial statements and their respective tax basis. Deferred income taxes reflect the net tax effects of (a) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts reported for income tax purposes, and (b) tax credit carryforwards. We record a valuation allowance for deferred tax assets when, based on our best estimate of taxable income (if any) in the foreseeable future, it is more likely than not that some portion of the deferred tax assets may not be realized. At March 31, 2011 and December 31, 2011, we had net deferred tax assets relating primarily to tax net operating loss carryforwards and a 100% valuation allowance on such net deferred tax assets. We had no significant current tax provision for any period presented.

SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS

There were no recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Public Accountants, or the Securities and Exchange Commission that in the opinion

of management had, or are expected to have a material impact on our present or future consolidated financial statements.

NOTE 4. NOTES PAYABLE

Notes payable, all current liabilities and unsecured, consist of the following at December 31, 2011 and March 31, 2011:

	December 31, 2011		March 31, 2011	
	Principal Balance	Accrued Interest	Principal Balance	Accrued Interest
12% Notes payable, past due	$185,000	$291,377	$185,000	$270,562
10% Note payable, past due	5,000	6,188	5,000	4,875
Law Firm Note, past due	34,610	2,480	—	—
Tonaquint Note	360,186	1,776	—	—
Total	$584,796	$301,821	$190,000	$275,437

LAW FIRM NOTE

On August 2 2011, we entered into a Promissory Note with our intellectual property law firm for the amount of $49,610, which represented the amount we owed to that firm. The Promissory Note calls for monthly payments of $5,000 from August 2011 through December 2011. From the period August 2 through December 31, 2011, we made three $5,000 payments, and as a result, have reduced the note balance to $34,610 as of December 31, 2011. The note bears interest at 10% per annum.

TONAQUINT NOTE

On June 28, 2011, we entered into a Termination Agreement with Tonaquint, Inc. (See Note 5) under which both parties agreed that in consideration of the termination of a warrant, the waiving of all fees, penalties, the creation of the selling program and other factors, we agreed to issue an unsecured non-convertible promissory note (the "New Note") in the principal amount of $360,186, which provides for annual interest at a rate of 6%, payable monthly in either cash or our stock, at our option. The New Note has a maturity date of April 30, 2012.

NOTE 5. CONVERTIBLE NOTES PAYABLE

Convertible Notes Payable consist of the following at December 31, 2011:

	Principal	Unamortized Discount	Net Amount	Accrued Interest
Amended and Restated Series A 12% Convertible Notes, past due	$900,000	$—	$900,000	$135,000
2008 10% Convertible Notes, past due	25,000	—	25,000	10,729
December 2006 10% Convertible Notes, past due	17,000	—	17,000	12,608
May & June 2009 10% Convertible Notes, past due	75,000	—	75,000	61,321
July & August 2009 10% Convertible Notes, past due	32,500	—	32,500	39,773
October & November 2009 10% Convertible Notes, past due	75,000	—	75,000	19,688
February 2010 10% Convertible Note	240,578	—	240,578	21,920
April 2010 10% Convertible Note	75,000	—	75,000	13,625
September 2010 10% Convertible Notes	368,100	—	368,100	58,361
April 2011 10% Convertible Notes	400,400	(384,483)	15,917	30,030
July and August 2011 10% Convertible Notes	357,655	(178,812)	178,843	15,321
September 2011 Convertible Notes	253,760	(142,073)	111,687	—
November 2011 Convertible Notes	525,000	(176,800)	348,200	14,085
Total – Convertible Notes	$3,344,993	$(882,168)	$2,462,825	$432,461

Convertible Notes Payable consisted of the following at March 31, 2011:

	Principal	Unamortized Discount	Net Amount	Accrued Interest
Amended Series A 10% Convertible Notes, past due	$900,000	$—	$900,000	$33,750
2008 10% Convertible Notes, past due	25,000	—	25,000	7,917
December 2006 10% Convertible Notes, past due	17,000	—	17,000	10,696
May & June 2009 10% Convertible Notes, past due	200,000	—	200,000	33,292
July & August 2009 10% Convertible Notes, past due	87,500	—	87,500	32,020
October & November 2009 10% Convertible Notes	205,250	(17,226)	188,024	30,788
February 2010 10% Convertible Note	715,578	—	715,578	59,273
April 2010 10% Convertible Note	75,000	(73,222)	1,778	7,063
June 2010 12% Convertible Notes, past due	21,189	—	21,189	636
July 2010 6% Convertible Notes	495,343	(494,770)	573	35,107
September 2010 10% Convertible Notes	739,200	(713,990)	25,210	42,709
Total - Convertible Notes	$3,481,060	$(1,299,208)	$2,181,852	$293,251

All of the Convertible Notes Payable in the above tables are unsecured and are presently past due or will be due within one year of the December 31, 2011 balance sheet date. As a result, we expect to amortize all of the remaining discounts during the first half of calendar year 2012.

AMENDED AND RESTATED SERIES A 12% CONVERTIBLE NOTES

In June 2010, we entered into Amended and Restated 12% Series A Convertible Promissory Notes (the "Amended and Restated Notes") with the holders of certain promissory notes previously issued by the Company (“Amended Series A 10% Convertible Notes” or the "Prior Notes"), and all amendments to the Prior Notes.

The Amended and Restated Notes, in the principal amount of $900,000, are convertible into an aggregate of 4,500,000 shares of our common stock subject to antidilution adjustments, including down round price protection, and matured on December 31, 2010. In connection with the restructuring we paid $54,001 of accrued and default interest through the date of the restructuring, liquidated damages of $205,000 and $54,003 of prepaid interest through the expiration date in the aggregate amount of $313,004 through the issuance of units ("Units") at a fixed rate of $0.20 per Unit, each Unit consisting of one share of our common stock and one common stock purchase warrant to purchase one share of our common stock at a fixed exercise price of $0.20 per share as prescribed in the Amended and Restated Note Agreement.

In addition to the extension of the expiration date of the Amended and Restated Notes to December 31, 2010, we agreed to increase the annual interest rate from ten percent to twelve percent. We also agreed to change the exercise prices on all of the warrants held by the noteholders to $0.20 per share, to change certain formerly contingent warrants to non-contingent warrants and to extend the expiration date of their warrants to February 2016. The following table summarizes the number of shares of our common stock issuable upon the conversion of the Amended and Restated Notes or the exercise of the various warrants issued or issuable pursuant to the Amended and Restated Notes.

Note Conversion	$ 4,500,000
Warrants	11,646,125
Total	$ 16,146,125

For accounting purposes, the amendment of the 12% Series A Convertible Notes was treated as a debt extinguishment in accordance with FASB ASC 470-50, Debt-Modifications and Extinguishments, as the terms of the restructured agreements were deemed to be substantially different than those of the prior agreements.

Based on conversion and exercise price re-set provisions included in the Amended and Restated Notes warrant agreements, the embedded conversion feature and the related warrants, with an aggregate estimated fair value of approximately $3,089,000, were classified as derivative liability instruments (See Note 9).

Consequently, at the amendment date we recorded a loss on extinguishment of $2,226,924 as follows:

Reacquisition price	$4,385,925
Less carrying value of notes and related instruments	(2,159,001)
Loss on extinguishment	$2,226,924

As of December 31, 2010, the Amended and Restated Notes matured and as of December 31, 2011 are in default.

We have begun discussions with the noteholders regarding an extension to the notes but there can be no assurance that we will be able to do so on terms that we deem acceptable or at all.

2008 10% CONVERTIBLE NOTES

One 2008 10% Convertible Note in the amount of $25,000 which matured in January 2010 remains outstanding at December 31, 2011. This note is convertible into our common stock at $0.50 per share. During the fiscal year ended March 31, 2011 we agreed to convert the $20,000 principal and related accrued interest of $5,562 of one holder of the 2008 10% Convertible Note into 127,808 shares of common stock based upon a conversion ratio of $0.20 per share rather than at the stated conversion ratio of $0.50 per share. As a result of this change, we recorded a charge of $15,337 as interest expense in the fiscal year ended March 31, 2011.

DECEMBER 2006 10% CONVERTIBLE NOTES

At December 31, 2011, $17,000 of the December 2006 10% Notes remained outstanding and in default. These notes are convertible into our common stock at $0.17 per share.

MAY & JUNE 2009 10% CONVERTIBLE NOTES

In May and June 2009, we raised an aggregate amount of $350,000 from the sale to accredited investors of 10% convertible notes ("May & June 2009 10% Convertible Notes"). The May & June 2009 10% Convertible Notes matured at various dates between November 2010 through December 2010 and are convertible into our common stock at a fixed conversion price of $0.20 per share prior to maturity. Upon conversion of the May and June 2009 10% Convertible Notes, the note holders will receive a matching three year warrant to purchase unregistered shares of our common stock at a price of $0.20 per share.

After consideration of the warrants, we recorded a discount associated with the beneficial conversion feature of $233,735 related to the May & June 2009 10% Convertible Notes and we amortized that discount over the terms of the respective convertible notes using the effective interest method.

The following conversions of the May & June 2009 10% Convertible Notes have taken place during the fiscal years ended March 31, 2011 and 2010:

	Fiscal Year Ended March 31, 2010	Fiscal Year Ended March 31, 2011
Principal converted	$50,000	$100,000
Accrued interest converted	$2,803	$15,039
Warrants issued	250,000	500,000

As a result of the warrant issuances, we recorded charges of $31,550 and $74,652 as additional interest expense in the fiscal years ended March 31, 2010 and 2011, respectively.

On or about June 23, 2011, the holder of the two remaining May & June 2009 10% Convertible Notes, John Barsell, filed a complaint against us entitled *John E. Barsell v. Aethlon Medical, Inc*., in the Superior Court of the State of California for the County of San Diego, Case No. 37-2011-00093374 (the “Lawsuit”). The complaint alleged breach of contract in connection with certain notes in the aggregate principal amount of $200,000 issued by us to Barsell in 2009. On August 15, 2011, we and Barsell signed a Settlement Agreement under which we agreed to repay the notes and related accrued interest in cash or in common stock, at the election of the Company, on a monthly basis over approximately a ten month period of time. In exchange, Barsell dismissed the Lawsuit without prejudice. The agreed monthly payments are $25,000 if in cash or $30,000 if in stock with $25,000 of the $30,000 amount going towards principal reduction and the remaining $5,000 as a penalty for paying in stock.

Following the Settlement Agreement and through December 31, 2011, Barsell converted $125,000 of principal into 2,437,425 shares of our common stock over five monthly issuances. Those share issuances also covered $25,000 in penalties as noted above.

At December 31, 2011, the remaining principal balance of $75,000 was in default (see Note 13).

JULY & AUGUST 2009 10% CONVERTIBLE NOTES

In July and August 2009, we raised an aggregate amount of $668,250 from the sale to three investment funds of 10% convertible notes ("July & August 2009 10% Convertible Notes"). Each note carried a one-year term and is convertible into our common stock at 80% of market with a floor of $0.15 cents and a ceiling of $0.25 cents per share. As additional consideration, the investors also received 1,336,500 three year warrants to purchase our common stock at $0.50 per share, although that exercise price is subject to change based on certain conditions. The conversion feature may additionally be adjusted in the event of future financing by the Company. Because the conversion feature and warrant exercise price each can be reset based on future events, they are classified as derivative liability instruments.

Based on the initial estimated fair value of the conversion feature and warrants, we recorded a discount associated with the derivative liability of $475,762, which was amortized using the effective interest method over the one-year term of the notes. Deferred financing costs incurred in connection with this financing totaled $60,750, which were capitalized and are being amortized using the effective interest method over the one-year term of the notes.

The following conversions of the July & August 2009 10% Convertible Notes have taken place during the fiscal years ended March 31, 2011 and 2010:

	Fiscal Year Ended March 31, 2010	Fiscal Year Ended March 31, 2011
Principal converted	$330,000	$250,750
Accrued interest converted	$22,559	$10,698

14

At December 31, 2011, the remaining principal balance of $32,500 was in default.

OCTOBER & NOVEMBER 2009 10% CONVERTIBLE NOTES

In October and November 2009, we raised $430,000 from the sale to accredited investors of 10% convertible notes ("October & November 2009 10% Convertible Notes"). The October & November 2009 10% Convertible Notes mature at various dates between April 2011 and May 2011 and are convertible into our common stock at a fixed conversion price of $0.25 per share prior to maturity. The investors also received matching three year warrants to purchase unregistered shares of our common stock at a price of $0.25 per share. We measured the fair value of the warrants and the beneficial conversion feature of the notes and recorded a 100% discount against the principal of the notes. We are amortizing this discount using the effective interest method over the term of the notes.

The following conversions of the October & November 2009 10% Convertible Notes took place during the fiscal years ended March 31, 2011 and 2010:

	Fiscal Year Ended March 31, 2010	Fiscal Year Ended March 31, 2011
Principal converted	$70,000	$175,000
Accrued interest converted	$—	$8,750

The following conversions of the October & November 2009 10% Convertible Notes took place during the nine months ended December 31, 2011:

	Nine Months Ended December 31, 2011
Principal converted	$130,250
Accrued interest converted	$21,288

Deferred financing costs of $20,250 incurred in connection with this financing were issued in the form of a convertible note with warrants on the same terms as those received by the investors. We capitalized the $20,250 of deferred financing costs and amortized them over the term of the notes using the effective interest method.

At December 31, 2011, the remaining principal balance of $75,000 was in default.

FEBRUARY 2010 10% CONVERTIBLE NOTE

On February 12, 2010, we raised $280,015 in cash and received a secured promissory note in the amount of $300,000 in exchange for the issuance by the Company of a $660,000 principal amount 10% convertible promissory note (the "Note") to Gemini Master Fund, Ltd. ("Gemini"). The Note included an original issue discount of ten percent, or $60,000, and an origination fee of three percent, or $9,000. We also paid legal fees of $10,985. The Note issued by the Company matured in February 2011. The terms of the promissory note included a maturity date of April 1, 2011, and allowed for prepayments of principal and interest by Gemini beginning on September 1, 2010.

The conversion price per share initially was equal to eighty percent (80%) of the average of the three lowest closing bid prices of our common stock as reported by Bloomberg L.P. on the Principal Market for the ten (10) trading days preceding the conversion date, subject to a maximum price per share of $0.30 and a minimum price per share of $0.20 (the "Floor Price"). The Note is convertible into a maximum of 3,300,000 shares of our common stock at the minimum price per share of $0.20. The investor also received 660,000 three-year warrants to purchase shares of our common stock at $0.50 per share, although that exercise price is subject to change based on certain conditions. The conversion feature, including the Floor Price, may additionally be adjusted in the event of future financing by the Company. Because the conversion feature and warrant exercise price each can be reset based on future events, they have been classified as derivative liabilities.

The Note also contains other standard adjustment features for stock splits, recapitalizations and similar occurrences. The Note contains standard events of default related to payment, performance of certain covenants and bankruptcy events.

We recorded a debt discount of $478,476 based on the estimated fair value of the derivative liabilities associated with the warrants and embedded conversion feature which was amortized using the effective interest method over the term of the note.

In November 2010, certain terms of the Note were modified pursuant to a Settlement Agreement (the "Modified Agreement") which provides for the modification of the conversion price formula to equal eighty percent (80%) of the average of the three lowest closing bid prices of the common stock as reported by Bloomberg L.P. on the Principal Market for the twenty (20) trading days preceding the conversion date in lieu of the ten (10) trading days preceding the conversion date.

According to the modified terms, the previous conversion floor price was replaced with a maximum share limitation under which the maximum number of shares of common stock that may be issued to the holder of the Note pursuant to a conversion of the Note, combined with an exercise of the Exchange Warrant (as defined below), shall not exceed a cap determined by (a) dividing the sum of (i) the face amount of the Note, plus (ii) an amount equal to all interest that would accrue under the Note during its term (assuming no payments of principal or interest are made prior to the maturity date of the Note), by a price per share of common stock equal to $0.20 (subject to equitable adjustment) and (b) then adding the sum calculated pursuant to the foregoing clause (a) to the maximum number of warrant shares (as defined in the Exchange Warrant) that may be acquired by the holder thereof upon exercise of the Exchange Warrant (regardless of whether such exercise is a cashless exercise). In addition, the "maximum ownership percentage" under the Note was increased to 9.99%.

In addition to the modifications of the note, we agreed to exchange the original warrant for a new common stock purchase warrant (the "Exchange Warrant") for the purchase of 2,727,272 shares of common stock at an initial exercise price of $0.231 per share. The Exchange Warrant provides for anti-dilution adjustment to the exercise price in the event of the issuance of securities by the Company below the exercise price, subject to certain exceptions as set forth in the Exchange Warrant.

In addition, the Modified Agreement provided that Gemini deliver to us $253,794.09 by wire transfer in full payment of the promissory note, which represents the outstanding principal balance thereof plus all accrued but unpaid interest thereon less the origination fee due to Gemini under the original transaction documents less reimbursement of Gemini's legal expenses. In accordance with the settlement, we delivered to Gemini 286,483 freely tradable shares of common stock in full satisfaction of the remaining number of shares of common stock due under certain conversion notices, for a total of $75,000, previously delivered by Gemini to the Company. The Modified Agreement provided for the mutual release of all claims related to the dispute and the revocation of all prior notices of default sent by the Company and Gemini to each other.

In connection with the modification to the note and the issuance of the Exchange Warrant, the maximum number of shares issuable pursuant to the maximum share limitation and the exercise in full of the Exchange Warrant was 6,357,272.

As provisions of the Modified Agreement resulted in terms that were deemed to be substantially different from the original terms, the exchange of debt instruments was accounted for as a debt extinguishment and we recorded a loss on extinguishment of debt in the amount of $963,018 in the fiscal year ended March 31, 2011 as shown below:

Reacquisition price	$1,854,767
Less carrying value of notes and related instruments	(891,749)
Loss on extinguishment	$963,018

On March 21, 2011, we entered into an Extension Agreement (the "Extension Agreement") with Gemini. The Extension Agreement provides for, among other things, the extension of the Maturity Date to October 1, 2011, and an amendment and restatement of the Note to reflect the revised principal amount of $740,578, which amount includes accrued interest of $58,981, the remaining principal balance of $585,000 and a 15% premium to the principal and accrued interest amount in consideration for the extension. In addition, the Note as amended provides for a new "share cap formula" such that the number of shares of Common Stock issuable upon conversion of the Note shall not exceed a cap determined by (a) dividing the sum of (i) the revised principal amount of the Note ($740,578), plus (ii) an amount equal to all interest that would accrue under the Note during its term (assuming no payments of principal or interest are made after March 21, 2011 but prior to the Maturity Date), by a price per share of Common Stock equal to $0.16 (subject to adjustment as set forth in the Note) and (b) then adding the sum calculated pursuant to the foregoing clause to the maximum aggregate number of shares of Common Stock issuable under certain warrants held by Gemini (regardless of whether such exercise is a cashless exercise).

As provisions of the Extension Agreement resulted in terms that were deemed to be substantially different from the original terms, the exchange of debt instruments was accounted for as a debt extinguishment and we recorded a loss on extinguishment of debt in the amount of $47,701 in the fiscal year ended March 31, 2011 as shown below:

Reacquisition price	$773,582
Less carrying value of notes and related instruments	(725,881)
Loss on extinguishment	$47,701

The following conversions of the February 2010 10% Convertible Note have taken place during the nine months ended December 31, 2011:

	Nine Months Ended December 31, 2011
Principal converted	$475,000
Accrued interest converted	$19,403

On December 29, 2011, we agreed with Gemini to extend the expiration date of the Note to April 1, 2012. There was no fee or any other consideration exchanged in connection with the extension.

APRIL 2010 10% CONVERTIBLE NOTE

In April 2010, we raised $75,000 from the sale to an accredited investor of a 10% convertible note. The convertible note matures in October 2011 and is convertible into our common stock at a fixed conversion price of $0.25 per share prior to maturity. The investor also received three year warrants to purchase 300,000 unregistered shares of our common stock at a price of $0.25 per share.

We measured the fair value of the warrants and the beneficial conversion feature of the notes and recorded a 100% discount against the principal of the notes. We are amortizing this discount using the effective interest method over the term of the note.

At December 31, 2011, the principal balance of $75,000 was in default.

JUNE 2010 12% CONVERTIBLE NOTES

In June 2010, in connection with the present and past negotiations with the law firm representing the holders of the "Amended and Restated Notes," we issued two convertible notes to that law firm (“June 2010 12% Convertible Notes”) totaling $64,153 on the same terms as the Amended and Restated Notes. That amount represented the amount of their legal fees plus accrued interest. During the fiscal year ended March 31, 2011, the holder converted to common stock one of the convertible notes in the amount of $42,964.

During the three months ended September 30, 2011, the holder converted the remaining principal balance of $21,189 and accrued interest of $2,598 to shares of our common stock per the terms of the convertible note.

JULY 2010 6% CONVERTIBLE NOTES

In July 2010, we entered into a Note and Warrant Purchase Agreement (the "Purchase Agreement") with Tonaquint, Inc., a Utah corporation (the "Investor") whereby we issued and sold, and the Investor purchased: (i) a Convertible Promissory Note of the Company in the principal amount of $890,000 (the "Company Note") and (ii) a Warrant to purchase common stock of the Company (the "Warrant"). As consideration for the issuance and sale of the Company Note and Warrant, the Investor paid cash in the amount of $400,000 and issued two Secured Trust Deed Notes to us (the "Trust Notes") each in the principal amount of $200,000. The variance of $90,000 represents fees and expenses paid by us and an original issue discount which was recorded as deferred offering costs.

The Company Note is convertible into shares of the Company's common stock, at the option of the Investor, at a price per share equal to (a) the principal and interest due under the Company Note divided by (b) 80% of the average of the closing bid price for the three (3) trading days with the lowest closing bid prices during the twenty (20) trading days immediately preceding the conversion date (the “Conversion Price”). In no event shall the Conversion Price be greater than the "Ceiling Price", which is $0.30 per share. The principal and interest subject to conversion under the Note shall be eligible for conversion in tranches ("Tranches"), as follows: (1) an initial Tranche in an amount equal to $450,000 and any interest and/or fees accrued thereon under the terms of the Company Note and the other Transaction Documents (as defined below and in the Purchase Agreement), and (2) two additional subsequent Tranches each in an amount equal to $220,000 and any interest or fees accrued thereon under the terms of the Company Note or the other Transaction Documents. The first subsequent Tranche shall correspond to payment of the first Trust Note and the second subsequent Tranche shall correspond to payment of the second Trust Note (as defined in the Purchase Agreement). The Investor's right to convert any of the subsequent Tranches is conditioned upon the Investor’s payment in full of the Trust Notes corresponding to such subsequent Tranche. Accordingly, principal and interest under the Company Note may only be converted by the Investor in proportion to the amounts paid under each of the Trust Notes. However, up to $450,000 may be converted at the Investor's option at any time, representing amounts paid by the Investor on the closing of the transaction on July 15, 2010 (the "Closing"). The Company Note bears interest at a rate of 6% per annum. The maturity date of the Company Note is July 15, 2011. The Company Note contains "anti-dilution" protection, such that if the Company issues and sells common stock, or securities convertible into or exercisable for common stock of the Company, at a price per share that is less than the applicable Conversion Price, then the Conversion Price is adjusted downward to match such lower issuance price. However, in no event will the Conversion Price based on anti-dilution adjustments be lower than the "Floor Price" which is $0.20 per share.

The number of shares of Common Stock that may be issued to the lender pursuant to a conversion of this Note, combined with an exercise of the Warrant, shall not exceed a cap determined by (a) dividing the sum of (i) the face amount of this Note, plus (ii) an amount equal to all interest that would accrue under this Note during its term (assuming no payments of principal or interest are made prior to the Maturity Date), by a price per share of Common Stock equal to $0.20 (the Floor Price).

17

The Company Note also contains other standard adjustment features for stock splits, recapitalizations and similar occurrences. The Company Note contains standard events of default related to payment, performance of certain covenants and bankruptcy events. We have granted the Investor a security interest in the Trust Notes under the terms of the Security Agreement. The sole collateral for the Company's payment and performance obligation under the Company Note is the Trust Notes. The Warrant entitles the Investor to purchase 3,636,364 shares of common stock at an exercise price of $0.231 per share. The Warrant contains "anti-dilution" protection, such that if we issue and sell common stock, or securities convertible into or exercisable for common stock of the Company, at a price per share that is less than the applicable exercise price, then the price is adjusted downward to match such lower issuance price. The Warrant also contains other standard adjustment features for stock splits, recapitalizations and similar occurrences.

We recorded a debt discount of $890,000 based on the estimated fair value of the derivative liabilities associated with the warrants and embedded conversion feature which was amortized using the effective interest method over the term of the note.

On June 28, 2011, we entered into a Termination Agreement with Tonaquint, Inc. under which both parties agreed to terminate the warrant to prevent continuing dilution of our common stock and to eliminate confusion or disagreement as to the number of shares of common stock available for issuance under the warrant in the future. Accordingly, under the Termination Agreement we issued 3,599,913 shares of common stock upon the final exercise of the warrant, whereupon the warrant was terminated and is of no further force or effect. The Termination Agreement also provides for a "Common Stock Sale Limitation" on all of our common stock held by Tonaquint, Inc. Under the "Common Stock Sale Limitation", the daily limitation on the number of shares of common stock which Tonaquint, Inc. may sell into the market on any trading day is limited to the greater of (i) $5,000 of sales amount, or (ii) 10% of the Average Daily Volume of our common stock sold on the Over The Counter Bulletin Board, where the Average Daily Volume shall mean the average daily volume for the prior three month period as reported on each trading day on Yahoo Finance with respect to our common stock. Under the terms of the Termination Agreement, Tonaquint, Inc. has waived and released us from any obligation to pay or perform any fees, penalties, costs, or assessments that were or are due, or would have become due, under the convertible note, the warrant and the note purchase agreement. In consideration of the termination of the warrant, the waiving of all fees, penalties, the creation of the selling program and other factors, we agreed to issue an unsecured non-convertible promissory note (the "New Note") in the principal amount of $360,185, which provides for annual interest at a rate of 6%, payable monthly in either cash or our stock, at our option. The New Note has a maturity date of April 30, 2012.

SEPTEMBER 2010 10% CONVERTIBLE NOTES

On September 3, 2010, we entered into a Subscription Agreement with three accredited investors (the “Purchasers”) providing for the issuance and sale of convertible promissory notes and corresponding warrants in the aggregate principal amount of $1,430,000. The initial closing under the Subscription Agreement resulted in the issuance and sale of (i) convertible promissory notes in the aggregate principal amount of $743,600, (ii) five-year warrants to purchase an aggregate of 3,718,000 shares of our common stock at an exercise price of $0.31125 per

share, and (iii) five-year warrants to purchase an aggregate of 3,718,000 shares of our common stock at an exercise price of $0.43575 per share. The convertible promissory notes bear interest compounded monthly at the annual rate of ten percent (10%) and mature on September 3, 2011. The aggregate gross cash proceeds were $650,000, the balance of the principal amount representing a due diligence fee and an original issuance discount. The convertible promissory notes are convertible at the option of the holders into shares of our common stock at a price per share equal to eighty percent (80%) of the average of the three lowest closing bid prices of the common stock as reported by Bloomberg L.P. for the principal market on which the common stock trades or is quoted for the ten (10) trading days preceding the proposed conversion date. Subject to adjustment as described in the notes, the conversion price may not be more than $0.30 nor less than $0.20. There are no registration requirements with respect to the shares of common stock underlying the notes or the warrants.

The following conversions of the September 2010 10% Convertible Note have taken place during the nine months ended December 31, 2011:

	Nine Months Ended December 31, 2011
Principal converted	$375,500
Accrued interest converted	$19,255

At December 31, 2011, the remaining principal balance of $368,100 was in default.

18

APRIL 2011 10% CONVERTIBLE NOTES

In April 2011, we entered into a Subscription Agreement with two accredited investors (the “Purchasers”) providing for the issuance and sale of convertible promissory notes and corresponding warrants in the aggregate principal amount of $385,000. The closing under the Subscription Agreement resulted in the issuance and sale by us of (i) convertible promissory notes in the aggregate principal amount of $385,000, (ii) five-year warrants to purchase an aggregate of 4,004,000 shares of our common stock at an exercise price of $0.125 per share, and (iii) five-year warrants to purchase an aggregate of 4,004,000 shares of our common stock at an exercise price of $0.175 per share. The convertible promissory notes bear interest compounded monthly at the annual rate of ten percent (10%) and mature on April 1, 2012. The aggregate gross cash proceeds to us were $350,000, the balance of the principal amount representing a due diligence fee and an original issuance discount. The convertible promissory notes are convertible at the option of the holders into shares of common stock of the Registrant at a price per share equal to eighty percent (80%) of the average of the three lowest closing bid prices of the common stock as reported by Bloomberg L.P. for the principal market on which the common stock trades or is quoted for the ten (10) trading days preceding the proposed conversion date. Subject to adjustment as described in the notes, the conversion price may not be more than $0.20 nor less than $0.10. There are no registration requirements with respect to the shares of common stock underlying the notes or the warrants.

In addition, we issued (i) five-year warrants to purchase an aggregate of 812,500 shares of our common stock at an exercise price of $0.125 per share, and (iii) five-year warrants to purchase an aggregate of 812,500 shares of our common stock at an exercise price of $0.175 per share to the Purchasers. These warrants were issued as an antidilution adjustment under certain common stock purchase warrants held by Purchasers that were acquired from us in September 2010.

At December 31, 2011, the outstanding principal balance was $400,400.

JULY & AUGUST 2011 10% CONVERTIBLE NOTES

During the three months ended September 30, 2011, we raised $357,656 in 10% convertible notes. Those notes had a fixed conversion price of $0.09 per share and carried an interest rate of 10%. The convertible notes mature in July and August 2012. We also issued those investors five year warrants to purchase 3,973,957 shares of common stock at $0.125 per share.

We measured the fair value of the warrants and the beneficial conversion feature of the notes and recorded a $257,926 discount against the principal of the notes. We are amortizing this discount using the effective interest method over the term of the note.

SEPTEMBER 2011 CONVERTIBLE NOTES

On September 23, 2011, we entered into a Subscription Agreement with two accredited investors (the “Purchasers”) providing for the issuance and sale of convertible promissory notes and corresponding warrants in the aggregate principal amount of $253,760. The warrants carried a five-year term to purchase an aggregate of 3,625,143 shares of our common stock at an exercise price of $0.10 per share. The convertible promissory notes do not bear an interest rate and mature on September 23, 2012. The aggregate net cash proceeds to us were $175,000, the balance of the principal amount representing a due diligence fee and an original issuance discount. The convertible promissory notes are convertible at the option of the holders into shares of our common stock at a price per share equal to seven cents. Subject to adjustments as described in the notes, the conversion price may not be more than seven cents. There are no registration requirements with respect to the shares of common stock underlying the notes or the warrants.

We measured the fair value of the warrants and the beneficial conversion feature of the notes and recorded a $168,804 discount against the principal of the notes. We are amortizing this discount using the effective interest method over the term of the note.

NOVEMBER 2011 CONVERTIBLE NOTES

In November 2011, we raised $525,000 in 5% Original Issue Discount Unsecured Convertible Debentures from five accredited investors pursuant to which the investors purchased an aggregate principal amount of $525,000 for an aggregate purchase price of $500,000. The debentures bear interest at 20% per annum and mature on April 20, 2012. The debentures will be convertible at the option of the holders at any time into shares of our common stock, at a conversion price equal to $0.0779, subject to adjustment. In connection with the debentures, the purchasers received warrants to purchase 3,369,706 shares of our Common Stock. The warrants are exercisable for a period of five years from the date of issuance at an exercise price of $0.11, subject to adjustment.

Until December 31, 2012, upon any proposed issuance by us of our common stock or equivalents (or a combination thereof as defined in the subscription agreement) for cash consideration, the purchasers may elect, in their sole discretion, to exchange all or some of the debentures then held by such purchaser for any securities issued in a subsequent financing on a $1.00 for $1.00 basis, provided, however , this right shall not apply with respect to (i) an Exempt Issuance (as defined in the debenture) or (ii) an underwritten public offering of our common stock.

A FINRA registered broker-dealer was engaged as placement agent in connection with the private placement. We paid the placement agent a cash fee in the amount of $50,000 (representing a 8% sales commission and a 2% unaccountable expense allowance) and will issue the placement agent or its designees warrants to purchase an aggregate of 808,729 shares of common stock at $0.11 per share. The warrants issued to the placement agent may be exercised on a cashless basis. In the event the placement agent exercises the warrants on a cashless basis, we will not receive any proceeds.

19

The securities sold in the private placement were not registered under the Securities Act, or the securities laws of any state, and were offered and sold in reliance on the exemption from registration afforded by Section 4(2) and Regulation D (Rule 506) under the Securities Act and corresponding provisions of state securities laws, which exempt transactions by an issuer not involving any public offering. The investors are “accredited investors” as such term is defined in Regulation D promulgated under the Securities Act.

At December 31, 2011, the interest payable on these notes totaled $14,085.

NOTE 6. EQUITY TRANSACTIONS

During the nine months ended December 31, 2011, we issued 24,413,568 shares of restricted common stock in exchange for the partial or full conversion of principal and interest of several convertible notes payable in an aggregate amount of $1,806,879 at an average conversion price of $0.07 per share based upon the conversion formulae in the respective notes.

During the nine months ended December 31, 2011, we issued 3,292,029 shares of stock to service providers for services valued at $328,327 based upon the fair value of the shares issued. Of that aggregate number, 2,864,488 shares of common stock were issued to consultants pursuant to our S-8 registration statements covering our Amended and Restated 2003 Consultant Stock Plan or 2010 Stock Incentive Plan for services valued at $272,077 based upon the fair value of the shares issued. The services were for regulatory affairs, primarily managing our hepatitis C trial in India, and corporate communications. The average issuance price on the S-8 issuances was approximately $0.09 per share. Additionally, we issued 427,541 restricted shares of common stock to service providers for investor relations valued at $56,250 based upon the fair value of the shares issued. The average issuance price on the restricted share issuances was approximately $0.13 per share.

During the nine months ended December 31, 2011, we issued 3,699,914 shares of restricted common stock related to net warrant cashless exercises.

In May 2011, we agreed to modify three warrants held by an institutional investor as the result of antidilution protection.

In May 2011, our Board ratified a six month consulting agreement with a consultant to provide public relations and corporate communications services. We agreed to pay the consultant a monthly fee of $1,500 in cash and a one-time stock-based payment of six months’ worth of shares based upon a rate of $5,000 per month, or a total of $30,000, to be

paid in restricted stock. Based upon the closing price of the date of the approval by our Board, the one-time restricted share payment was in the amount of 200,000 restricted shares.

NOTE 7. ACCRUED LIQUIDATED DAMAGES

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

We have entered into registration payment arrangements in connection with certain financing arrangements that require us to register the shares of common stock underlying the convertible debt and warrants issued in these financing transactions. Under these agreements we are liable for liquidated damages to the investors if we fail to file and/or maintain effective registration statements covering the specified underlying shares of common stock.

Since we have either failed to file, or failed to maintain the registration obligations under these agreements, as of December 31, 2011 and March 31, 2011 we have accrued estimated aggregate liquidated damages of $437,800 in connection with the liquidated damage provisions of these agreements, which we believe represents our maximum exposure under these provisions. Accordingly, we do not expect to accrue any further liquidated damages in connection with these agreements. The actual amount of liquidated damages paid, if any, may differ from our estimates as it is our intention to negotiate with the investors the settlement of liquidated damages due and, as such, the ultimate amounts we may actually pay may be less than the amount currently accrued.

NOTE 8. OTHER CURRENT LIABILITIES

At December 31, 2011 and March 31, 2011, our other current liabilities were comprised of the following items:

	December 31, 2011	March 31, 2011
Accrued interest	$734,282	$525,336
Accrued legal fees	240,242	236,902
Deferred rent	5,324	5,784
Other	42,588	36,364
Total other current liabilities	$1,022,436	$804,386

20

As of the date of this report, various promissory and convertible notes payable in the aggregate principal amount of $1,792,210 (as identified in Notes 4 and 5 above) have reached maturity and are past due. We are continually reviewing other financing arrangements to retire all past due notes. At December 31, 2011, we had accrued interest in the amount of $639,958 associated with these defaulted notes in accrued liabilities payable, which are included in the accrued interest numbers noted above (see Notes 4 and 5).

NOTE 9. FAIR VALUE MEASUREMENTS

We follow FASB ASC 820, "FAIR VALUE MEASUREMENTS AND DISCLOSURES" (“ASC 820”) in connection with financial assets and liabilities measured at fair value on a recurring basis subsequent to initial recognition. The guidance applies to our derivative liabilities.

ASC 820 requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories: We measure the fair value of applicable financial and non-financial assets based on the following fair value hierarchy:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The hierarchy noted above requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value.

The fair value of our recorded derivative liabilities is determined based on unobservable inputs that are not corroborated by market data, which is a Level 3 classification. We record derivative liabilities on our balance sheet at fair value with changes in fair value recorded in our consolidated statements of operations.

Our fair value measurements at the December 31, 2011 reporting date are classified based on the valuation technique level noted in the table below:

Description	December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative Liabilities	$1,250,705	$ --	$ --	$ 1,250,705
Total	$1,250,705	$ --	$ --	$ 1,250,705

Prior to the third fiscal quarter ended December 31, 2010 (“Q3 2011”), the fair value estimate relating to an aggregate of 25,066,944 warrants classified as derivative liabilities had been based on a Black-Scholes valuation model. During Q3 2011, we changed to a binomial lattice model for valuation of these warrants as we determined that use of a binomial lattice model was more representative of fair value in the circumstances. In accordance with accounting guidance in ASC 820-10, Fair Value Measurements and Disclosures, this was accounted for as a change in accounting estimate.

The following outlines the significant weighted average assumptions used to estimate the fair value information presented, in connection with our April 2011 convertible notes, July & August 2011 10% convertible notes and the September 2011 convertible notes and with respect to warrant and embedded conversion option derivative instruments utilizing the Binomial Lattice option pricing model:

	Nine Months Ended December 31, 2011
Risk free interest rate	0.02% - 2.24%
Average expected life	0.25 - 5 years
Expected volatility	51.9% - 128.5%
Expected dividends	None

The table below sets forth a summary of changes in the fair value of our Level 3 financial instruments for the nine months ended December 31, 2011:

	April 1, 2011	Recorded New Derivative Liabilities	Change in estimated fair value recognized in results of operations	Reclassification of Derivative Liability to Paid in capital	December 31, 2011
Derivative liabilities	$ 2,002,896	$ 1,107,940	($ 1,596,442)	($ 263,689)	$1,250,705

The fair value of derivative liabilities that we recorded in the nine months ended December 31, 2011 was related to our April 2011 convertible note, July & August 2011 10% convertible notes and the September 2011 convertible note offerings (see Note 5) and was based upon an independent valuation report.

The table below sets forth a summary of changes in the fair value of our Level 3 derivative liabilities for the nine months ended December 31, 2010:

	Fair Value at March 31, 2010	Recorded Fair Value of Derivative Liabilities in the nine month period ended December 2010	Change in Estimated Fair Value Recognized in Results of Operations	Fair Value at December 31, 2010
Derivative liabilities	$1,054,716	$6,980,347	$(2,098,954)	$5,936,109

The fair value of derivative liabilities that we recorded in the nine months ended December 2010 was related to the restructuring of the Amended and Restated Convertible Notes and to the embedded derivatives and associated warrants related to a number of our convertible note offerings (see Note 5) and was based upon an independent valuation report.

NOTE 10. STOCK COMPENSATION

The following table summarizes share-based compensation expenses relating to shares and options granted and the effect on basic and diluted loss per common share during the three and nine months ended December 31, 2011 and 2010:

	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010
Total share-based compensation expense	$161,440	$252,740	$609,503	$1,599,915
Total share-based compensation expense included in net loss	$161,440	$252,740	$609,503	$1,599,915
Basic and diluted loss per common share	$(0.00)	$(0.01)	$(0.01)	$(0.02)

The following table breaks out the components of our share-based compensation expenses relating to shares and options granted and the effect on basic and diluted loss per common share during the three and nine months ended December 31, 2011 and 2010.

	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010
Vesting of stock options	64,773	153,898	319,503	875,171
Incremental fair value of option modifications	—	2,175	—	499,188
Vesting expense associated with CEO restricted stock grant	96,667	96,667	290,000	225,556
Direct stock grants	—	—	—	—
Total share-based compensation expense	$161,440	$252,740	$609,503	$1,599,915
Total share-based compensation expense included in net loss	$161,440	$252,740	$609,503	$1,599,915
Basic and diluted loss per common share	$(0.00)	$(0.01)	$(0.01)	$(0.02)

We did not issue any stock options during the three and nine months ended December 31, 2011. All of the stock-based compensation expense recorded during the nine months ended December 31, 2011 and 2010, which totaled $609,503 and $1,599,915, respectively, is included in payroll and related expense in the accompanying condensed consolidated statements of operations. Stock-based compensation expense recorded during the three months ended December 31, 2011 had no impact on basic and diluted loss per common share and the stock-based compensation expense recorded during the three months ended December 31, 2010 increased basic and diluted loss per common share by $0.01. Stock-based compensation expense recorded during the nine months ended December 31, 2011 increased basic and diluted loss per common share by $0.01 and the stock-based compensation expense recorded during the nine months ended December 31, 2010 increased basic and diluted loss per common share by $0.02.

We review share-based compensation on a quarterly basis for changes to the estimate of expected award forfeitures based on actual forfeiture experience. The cumulative effect of adjusting the forfeiture rate for all expense amortization is recognized in the period the forfeiture estimate is changed. The effect of forfeiture adjustments for the nine months ended December 31, 2011 was insignificant.

The expected volatility is based on the historic volatility. The expected life of options granted is based on the "simplified method" as described in the SEC's guidance due to changes in the vesting terms and contractual life of current option grants compared to our historical grants.

Options outstanding that have vested and are expected to vest as of December 31, 2011 are as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years
Vested	17,562,026	$ 0.33	6.18
Expected to vest	2,116,667	$ 0.25	8.75
Total	19,678,693		

At December 31, 2011, there was approximately $969,836 of unrecognized compensation cost related to share-based payments, including the restricted stock grant, which is expected to be recognized over a weighted average period of 1.08 years.

On December 31, 2011, our stock options had a negative intrinsic value since the closing price on that date of $0.05 per share was below the weighted average exercise price of our stock options

In July 2011, our Board ratified a one year consulting agreement with a consultant to provide corporate advisory services. We agreed to pay the consultant a monthly fee of $5,000 in common stock.

NOTE 11. WARRANTS

A summary of warrant activity during the nine months ended December 31, 2011 is presented below:

	Amount	**Range of Exercise Price**	**Weighted Average Exercise Price**
Warrants outstanding at March 31, 2011	38,675,169	$0.15 - $0.50	$0.31
Exercised	(1,209,623)	$0.231	
Issued	22,914,533	$0.10 - $0.125	
Cancelled/Expired	(4,428,757)	$0.17 - $0.50	
Warrants outstanding at December 31, 2011	55,951,322	$0.10 - $0.25	$0.15
Warrants exercisable at December 31, 2011	55,951,322	$0.10 - $0.25	$0.15

The following outlines the significant weighted average assumptions used to estimate the fair value information presented, with respect to warrants utilizing the Binomial Lattice option pricing model at, and during the nine months ended December 31, 2011:

Risk free interest rate	0.10% - 2.24%
Average expected life	0.78 - 5 years
Expected volatility	82.1% - 86.6%
Expected dividends	None

NOTE 12. DARPA CONTRACT AND RELATED REVENUE RECOGNITION

As discussed in Note 1, we entered into a government contract with DARPA on September 30, 2011 and commenced work on such contract in October 2011. Only the base year (year one contract) is effective for the parties. Years two through five are subject to DARPA exercising their option to enter into contracts for those years. The year one contract contains eight milestones for which three have been achieved during the quarter ended December 31, 2011 as follows:

Milestone 2.2.1.1 – Write requirements definition for the extracorporeal blood purification system and acquire necessary equipment with a milestone payment of $358,284. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. We worked on this concept for a number of months beginning with a presentation to DARPA in late 2010. We subsequently filed for IP protection on certain of the key concepts in March 2011 and our management visited selected potential vendors to work out many of the details in the summer of 2011 before we were awarded the contract on September 30, 2011. We ordered the breadboard device from one of our vendors before the milestone payment was made. We designed the breadboard prototype and then presented the design to DARPA in order to achieve the milestone.

Milestone 2.2.1.2 -- Fabricate breadboard prototypes for anticoagulation-free anti-sepsis extracorporeal system (ASEPSYS) device. Fabricate prototype blood tubing sets. Acquire anti-thrombogenic surface modified hollow fiber plasma separators with a milestone payment $183,367. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. The consideration for this milestone covers the cost of having the breadboard prototype developed to our specifications, hiring an engineer to supervise the project, acquiring specially coated cartridges and associated overhead. The report was accepted by the contracting officer's representative and the invoice was submitted thereafter.

Milestone 2.2.2.1 – Begin to develop the ADAPT device to efficiently capture sepsis precursors and acquire important equipment and supplies with a milestone payment of $426,424. Management considers this milestone to be substantive as it was not dependent on the passage of time nor was it based solely on another party's efforts. It was critically important to obtain certain pieces of lab equipment as early as possible after winning the contract in order to measure the binding ability of sepsis precursors. We demonstrated that we were able to capture one of the identified possible sepsis precursors as part of our submission for approval. The consideration was also designed to cover the salaries of new and existing scientists, lab space, materials as well as fringe and corporate overhead.

NOTE 13. COMMITMENTS AND CONTINGENCIES

LEGAL MATTERS

From time to time, claims are made against us in the ordinary course of business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting us from selling one or more products or engaging in other activities.

The occurrence of an unfavorable outcome in any specific period could have a material adverse effect on our results of operations for that period or future periods. Other than the Barsell matter discussed earlier, we are not presently a party to any pending or threatened material legal proceedings.

LEASES

In October 2009, we entered into two new leases for office and laboratory space. The terms of the new leases are three years and two years, respectively, and the initial base lease payments are $6,045 per month and $1,667 per month, respectively.

On October 4, 2011 we entered into an amendment to extend our lease for our laboratory by an additional three years. The amendment also included additional tenant improvements in the approximate amount of $30,000.

NOTE 14. NOTE RECEIVABLE

On July 15, 2010, we received two Secured Trust Deed Notes to us (the "Trust Notes") each in the principal amount of $200,000 in connection with our issuance of a $890,000 principal amount 6% convertible promissory note to one accredited investor (See Note 5). The Trust Notes bear interest payable to us at five percent per annum and have maturity dates of September 15, 2011 and November 15, 2011. We recognize interest income on the Investor Note and Trust Notes as it is earned under the terms of the notes. The Investor Note and Trust Notes have prepayment options.

In February 2011, the investor paid the initial $200,000 amount to us along with related accrued interest of $5,945. During the three months ended June 30, 2011, the investor paid the second $200,000 amount to us along with accrued interest of $7,863. As a result, we no longer show a note receivable on our condensed consolidated balance sheet as of December 31, 2011.

NOTE 15. RELATED PARTIES

Due to working capital shortages, we have not been able to repay certain members of our senior management and board members for expenses incurred on behalf of the Company and occasionally have been unable to pay those individuals for their services. As of December 31, 2011 and March 31, 2011, we owed our senior management and board members $617,570, which is shown as due to related parties on the accompanying balance sheet.

Note 16. SUBSEQUENT EVENTS

Management has evaluated events subsequent to December 31, 2011 through the date that the accompanying condensed consolidated financial statements were filed with the Securities and Exchange Commission for transactions and other events which may require adjustment of and/or disclosure in such financial statements.

In January 2012, we shipped a diagnostic product that isolated exosomes from blood serum to a life sciences company and invoiced them for $1,432. We received payment in full under that invoice in February 2012. This represents our first commercial sale, which will be recorded in the March 2012 quarter.

During the period January 1, 2012 through February 15, 2012, we issued 2,255,188 shares of restricted common stock in exchange for the partial or full conversion of principal and interest of several convertible notes payable in an aggregate amount of $111,795 at an average conversion price of $0.05 per share based upon the conversion formulae in the respective notes.

During the period January 1, 2012 through February 15, 2012, we issued 109,529 shares of common stock to a service provider for services valued at $7,667 based upon the fair value of the shares issued. All of those shares were issued pursuant to our S-8 registration statements covering our Amended and Restated 2003 Consultant Stock Plan or 2010 Stock Incentive Plan. The services were for exosome-related research. The issuance price on the S-8 issuance was approximately $0.07 per share.

During the period January 1, 2012 through February 15, 2012, we issued 287,500 shares of restricted common stock as a patent license payment valued at $17,250.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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

FORWARD LOOKING STATEMENTS

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

THE COMPANY

We are a medical device company focused on creating innovative devices that address unmet medical needs in cancer, infectious disease and other life-threatening conditions. At the core of our developments is the Aethlon ADAPT™ (Adaptive Dialysis-Like Affinity Platform Technology) system, a medical device platform that converges single or multiple affinity drug agents with advanced plasma membrane technology to create therapeutic filtration devices that selectively remove harmful particles from the entire circulatory system without loss of essential blood components. Approval to embark on human trials is still needed to reach commercial viability of the Hemopurifier® and approval by the U.S. Food and Drug Administration ("FDA"). Successful outcomes of human trials will be required by the regulatory agencies of certain foreign countries where we intend to sell this device. We have submitted an Investigational Device Exemption ("IDE") to the FDA. Some of our patents may expire before FDA approval or approval in a foreign country, if any, is obtained. However, we believe that certain patent applications and/or other patents issued more recently will help protect the proprietary nature of the Hemopurifier® treatment technology.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the informational requirements of the Securities Exchange Act and must file reports, proxy statements and other information with the SEC. The reports, information statements and other information we file with the Commission can be inspected and copied at the Commission Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (800) SEC-0330. The Commission also maintains a Web site (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding registrants, like us, which file electronically with the Commission. Our headquarters are located at 8910 University Center Lane, Suite 660, San Diego, CA 92122. Our phone number at that address is (858) 459-7800. Our Web site is http://www.aethlonmedical.com.

RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2011 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2010

Revenues

We recorded government contract revenue of $958,075 in the three months ended December 31, 2011. This revenue arose from work performed under our government contract. On September 30, 2011, we entered into a contract with the United States of America, issued by SPAWAR Systems Center Pacific, pursuant to a contract award from the Defense Advanced Research Projects Agency (“DARPA”). Under the DARPA award, we have been engaged to develop a therapeutic device to reduce the incidence of sepsis, a fatal bloodstream infection that often results in the death of combat-injured soldiers. The award from DARPA is a fixed-price contract with potential total payments to us of $6,794,389 over the course of five years, including payments of up to $1,975,047 in the first year. Fixed price contracts require the achievement of multiple, incremental milestones to receive the full award during each year of the contract. Under the terms of the contract, we will perform certain incremental work towards the achievement of specific milestones against which we will invoice the government for fixed payment amounts. Assuming all such work is performed according to the contract terms, we will receive up to $1,975,047 of contract payments during the first twelve months of the contract with the aggregate payment amounts in years two through five varying between approximately $775,000 and $1.6 million. DARPA has the option to enter into the contract for years two through five. Only the contract related to the $1,975,047 has been formally entered into as of the date of this Form 10-Q filing. The milestones are comprised of planning, engineering and clinical targets, the achievement of which in some cases will require the participation and contribution of third party participants under the contract. There can be no assurance that we alone, or with third party participants, will meet such milestones to the satisfaction of the government and in compliance with the terms of the contract or that we will be paid the full amount of the contract revenues during any year of the contract term. We commenced work under the contract in October 2011.

As of December 31, 2011, we received two initial payments under the DARPA contract totaling $774,708 and have billed the government for a third invoice in the amount of $183,367, which is shown as an account receivable on our balance sheet.

Operating Expenses

Consolidated operating expenses for the three months ended December 31, 2011 were $1,299,403 in comparison with $1,046,701 for the comparable quarter a year ago. This increase of $252,702, or 24%, was due to an increase in general and administrative expenses of $258,899 and an increase in professional fees of $40,591, which were partially offset by a decrease in payroll and related expenses of $46,788.

The $258,899 increase in general and administrative expenses was primarily due to $237,367 of supplies and equipment purchased for the DARPA contract with no comparable expense in the 2010 period.

The $40,591 increase in our professional fees was largely due to an increase in our scientific consulting expense of $109,446, which in turn was primarily due to the cost of the Hepatitis C (HCV) trial in India. We also incurred approximately $40,000 of professional fees related to our DARPA contract. Those increases were partially offset by decreases of $67,075 in legal fees, $32,875 in marketing expenses and a reduction in our Board fees due to a timing difference between periods.

The $46,788 decrease in payroll and related expenses was primarily due to a number of stock option grants in the '10 period that included upfront vesting. The expense related to stock options was $252,740 in the '10 period and $161,191 in the '11 period, a $91,549 decrease. Excluding the change in stock option-related expense, our payroll increased by $44,761 as a result of hiring three new scientists for the DARPA project.

Other Expenses (Income)

Other expenses (income) consist primarily of the change in the fair value of our derivative liability, debt extinguishment charges other expense and interest expense. Other expenses for the three months ended December 31, 2011 were $233,390 in comparison with other expenses of $821,470 for the comparable quarter a year ago.

Change in Fair Value of Derivative Liability

Both periods include changes in the fair value of derivative liability. For the three months ended December 31, 2011, the change in the estimated fair value of derivative liability was a gain of $74,940 and for the three months ended December 31, 2010, the change in estimated fair value was a gain of $430,077.

Interest Expense

Interest expense was $308,386 for the three months ended December 31, 2011 compared to $594,128 in the corresponding prior period, a decrease of $285,742. The various components of our interest expense are shown in the following table:

	Quarter Ended December 31, 2011	Quarter Ended December 31, 2010	Change
Interest Expense	$127,654	$113,005	$14,649
Amortization of Deferred Financing Costs	57,179	151,616	(94,437)
Interest recorded in connection with issuance of conditional warrants	—	74,652	(74,652)
Amortization of Note Discounts	123,553	254,855	(131,302)
Total Interest Expense	$308,386	$594,128	$(285,742)

As noted in the above table, the three most significant factors in the $285,742 decrease in interest expense were (a) the $131,302 reduction in the amortization of note discounts, (b) the $74,652 in interest recorded in the 2010 period in connection with the issuance of conditional warrants with no comparable charge in the 2011 period and (c) the $94,437 reduction in amortization of deferred financing costs.

Loss on Extinguishment of Debt

In the three months ended December 31, 2010, we modified the conversion terms of the February 2010 convertible note and related warrant and as a result, we recorded a loss on extinguishment of debt in the amount of $963,018. That charge was calculated based on the change in fair value of the embedded conversion feature of the Note and in the warrants exchanged both immediately prior to and immediately after the Settlement date, as follows:

Reacquisition price	$1,854,767
Less carrying value of notes and related instruments	(891,749)
Loss on extinguishment	$963,018

We had no loss on extinguishment of debt in the three months ended December 31, 2011.

Net Loss

As a result of our government contract revenue more than offsetting the increased expenses noted above, we recorded a consolidated net loss of approximately $575,000 and $1,868,000 for the quarters ended December 31, 2011 and 2010, respectively.

Basic and diluted loss per common share were ($0.01) for the three month period ended December 31, 2011 compared to ($0.03) for the period ended December 31, 2010.

NINE MONTHS ENDED DECEMBER 31, 2011 COMPARED TO THE NINE MONTHS ENDED DECEMBER 31, 2010

Revenues

We recorded government contract revenue of $958,075 in the nine months ended December 31, 2011 as discussed above.

Operating Expenses

Consolidated operating expenses for the nine months ended December 31, 2011 were $3,214,839 in comparison with $3,618,687 for the comparable period a year ago. This decrease of $403,848, or 11%, was primarily due to a decrease in payroll and related expenses of $797,311, which was partially offset by increases in general and administrative expenses of $245,011 and in professional fees of $148,452.

The $797,311 decrease in payroll and related expenses was primarily due to a one-time charge of $491,377 related to the extensions to certain stock option agreements and a number of stock option grants in the '10 period that included upfront vesting. The expense related to stock options was $1,550,908 in the '10 period and $609,502 in the '11 period, a $941,406 decrease. Excluding the change related to stock options, our payroll would have increased by $ 144,095. $88,918 of that payroll increase was due to having our new president on our payroll for the entire nine month period in 2011 versus approximately 2 months in the 2010 period. The remainder of the increase was primarily due to hiring three new scientists in the December 2011 quarter to assist with the DARPA project.

The $245,011 increase in general and administrative expenses was primarily due to $237,367 of supplies and equipment purchased for the DARPA contract with no comparable expense in the 2010 period.

The $148,452 increase in our professional fees was largely due to an increase in our scientific consulting expense of $251,103, which in turn was primarily due to the cost of the HCV clinical trial in India. We also incurred approximately $40,000 of professional fees related to our DARPA contract. Those increases were partially offset by decreases of $89,806 of business development expenses and $44,065 in our accounting fees.

Other Expenses (Income)

Other expenses (income) consist primarily of the change in the fair value of our derivative liability, debt extinguishment charges other expense and interest expense. Other expenses for the nine months ended December 31, 2011 were $1,357,331 in comparison with $4,486,442 for the comparable period a year ago.

Change in Fair Value of Derivative Liability

Both periods include changes in the fair value of derivative liability. For the nine months ended December 31, 2011, the change in the estimated fair value of derivative liability was a gain of $1,596,442 and for the nine months ended December 31, 2010, the change in estimated fair value was a gain of $2,098,954.

Loss on Extinguishment of Debt

In June 2010, we entered into Amended and Restated 12% Series A Convertible Promissory Notes (the "Amended and Restated Notes") with the holders of certain promissory notes previously issued by the Company (“Amended Series A 10% Convertible Notes” or the "Prior Notes"), and all amendments to the Prior Notes. In connection with amendments to the Prior Notes, during the three months ended June 30, 2010, we recorded a loss on extinguishment of debt of $2,226,924 and a related loss on settlement of accrued interest and damages of $68,703. There were no comparable expenses in the three months ended June 30, 2011. For accounting purposes, the amendment of the 12% Series A Convertible Notes was treated as a debt extinguishment in accordance with FASB ASC 470-50, Debt Modifications and Extinguishments as the terms of the restructured agreements were deemed to be substantially different from those of the prior agreements.

Based on conversion and exercise price re-set provisions included in the amended convertible debt and new and amendment warrant agreements, the embedded conversion feature of the Amended and Restated 12% Convertible Notes and the related warrants were classified as derivative liability instruments (See Note 9).

Consequently, at the amendment date we recorded a loss on extinguishment of $2,226,924 as follows:

Reacquisition Price	$4,385,925
Less carrying value of notes and related instruments	(2,159,001)
Loss on extinguishment	$2,226,924

In the three months ended December 31, 2010, we modified the conversion terms of the February 2010 convertible note and related warrant and as a result, we recorded a loss on extinguishment of debt in the amount of $963,018. That charge was calculated based on the change in fair value of the embedded conversion feature of the Note and in the warrants exchanged both immediately prior to and immediately after the Settlement date, as follows:

Reacquisition price	$1,854,767
Less carrying value of notes and related instruments	(891,749)
Loss on extinguishment	$963,018

The combination of the $2,226,924 loss on extinguishment related to the Amended and Restated Notes and the $963,018 loss on extinguishment related to the February 2010 convertible note resulted in a total loss on extinguishment of $3,189,942 for the nine months ended December 31, 2010.

We had no loss on extinguishment of debt in the nine months ended December 31, 2011.

Interest Expense

Interest expense was $2,594,526 for the nine months ended December 31, 2011 compared to $3,346,247 in the corresponding prior period, a decrease of $751,721. The various components of our interest expense are shown in the following table:

	Nine Months Ended December 31, 2011	Nine Months Ended December 31, 2010	Change
Interest Expense	$352,571	$341,231	$11,340
Amortization of Deferred Financing Costs	243,878	242,893	985
Liquidated Damages	—	392,000	(392,000)
Interest recorded in connection with issuance of conditional warrants	—	74,652	(74,652)
Interest recorded in connection with warrant extension	—	138,468	(138,468)
Interest recorded in connection with additional derivative liabilities	538,736	1,103,282	(564,546)
Amortization of Note Discounts	1,459,341	1,053,721	405,620
Total Interest Expense	$2,594,526	$3,346,247	$(751,721)

As noted in the above table, the most significant factors in the $751,721 decrease in interest expense were (a) the $564,546 change in the adjustment to derivative liabilities between the periods, (b) the $392,000 charge for liquidated damages in the 2010 period with no comparable charge in the 2011 period, and (c) the $138,468 charge taken in the 2010 period related to the extension of certain warrants with no comparable charge in the 2011 period, all of which were partially offset by the combined $405,620 increase in amortization of note discounts.

Net Loss

As a result of the combination of recording revenue and the decreased expenses noted above, we recorded a consolidated net loss of approximately $3,614,000 and $8,105,000 for the nine month periods ended December 31, 2011 and 2010, respectively.

Basic and diluted loss per common share were ($0.04) for the nine month period ended December 31, 2011 compared to ($0.12) for the nine month period ended December 31, 2010.

LIQUIDITY AND CAPITAL RESOURCES

We are a medical device company that has begun to generate revenues from a government contract. We are focused on creating innovative devices that address unmet medical needs in cancer, infectious disease and other life-threatening conditions. At the core of our developments is the Aethlon ADAPT™ (Adaptive Dialysis-Like Affinity Platform Technology) system, a medical device platform that converges single or multiple affinity drug agents with advanced plasma membrane technology to create therapeutic filtration devices that selectively remove harmful particles from the entire circulatory system without loss of essential blood components. Approval to embark on human trials is still needed to reach commercial viability of the Hemopurifier® and approval by the U.S. Food and Drug Administration ("FDA"). Successful outcomes of human trials will be required by the regulatory agencies of certain foreign countries where we intend to sell this device. We have submitted an Investigational Device Exemption ("IDE") to the FDA. Some of our patents may expire before FDA approval or approval in a foreign country, if any, is obtained. However, we believe that certain patent applications and/or other patents issued more recently will help protect the proprietary nature of the Hemopurifier® treatment technology.

To date, we have funded our capital requirements for the current operations from revenue from our government contract, net funds received from the public and private sale of debt and equity securities, as well as from the issuance of common stock in exchange for services. Our cash position at December 31, 2011 was approximately $355,000 compared to approximately $16,000, at March 31, 2011, representing an increase of approximately $339,000. During the nine months ended December 31, 2011, operating activities used net cash of approximately $1,101,000, while we received approximately $1,442,000 from financing activities from the issuance of convertible notes and the collection of secured notes receivable. In addition, during this period we used approximately $2,000 in investing activities related to expenditures related to fixed asset acquisitions.

During the nine month period ended December 31, 2011, net cash used in operating activities resulted primarily from our net loss of approximately $3,614,000 offset by the amortization of note discounts of approximately $1,703,000, non-cash interest expense of $539,000, a non-cash charge of $360,186 related to the termination of the Tonaquint financing arrangement, the fair market value of common stock of approximately $328,000 issued in payment for services, approximately $610,000 in stock-based compensation and the net change in operating assets and liabilities of approximately $556,000. Those factors were partially offset by the non-cash gain of approximately $1,596,000 relating to the change in the estimated fair value of derivative liability.

On September 30, 2011, we entered into a contract with the United States of America, issued by SPAWAR Systems Center Pacific, pursuant to a contract award from the Defense Advanced Research Projects Agency (“DARPA”). Under the DARPA award, we have been engaged to develop a therapeutic device to reduce the incidence of sepsis, a fatal

bloodstream infection that often results in the death of combat-injured soldiers. The contract program will utilize the Aethlon ADAPT™ system as a core technology component underlying an extracorporeal blood purification device that selectively clears multiple sepsis-enabling particles from circulation to promote recovery and prevent sepsis. Under the contract program, we will also introduce a novel blood pump strategy to reduce or eliminate the systemic administration of anticoagulants normally required during extracorporeal device therapies.

The award from DARPA is a fixed-price contract with potential total payments to us of $6,794,389 over the course of five years, including payments of up to $1,975,047 in the first year. Years two through five are at DARPA's discretion. Fixed price contracts require the achievement of multiple, incremental milestones to receive the full award during each year of the contract. Under the terms of the contract, we will perform certain incremental work towards the achievement of specific milestones against which we will invoice the government for fixed payment amounts. Assuming all such work is performed according to the contract terms, we will receive up to $1,975,047 of contract payments during the first twelve months of the contract with the aggregate payment amounts in years two through five approximating $4.8 million, assuming DARPA exercises their option to extend the contract for years two through five.. The milestones are comprised of planning, engineering and clinical targets, the achievement of which in some cases will require the participation and contribution of third party participants under the contract. We will be subject to quarterly reviews by the government to assess performance, milestone achievement and any required modification of the milestone and payment schedules under the contract. There can be no assurance that we alone, or with third party participants, will meet such milestones to the satisfaction of the government and in compliance with the terms of the contract or that we will be paid the full amount of the contract revenues during any year of the contract term. We commenced work under the contract in October 2011.

During the three months ended December 31, 2011, we received payments under the DARPA contract in the amount of $774,708 and invoiced the government for an additional $183,367 for total revenue recognized of $958,075.

A decrease in working capital during the nine months ended December 31, 2011 in the amount of approximately $119,000 changed our negative working capital position to approximately ($6,252,000) at December 31, 2011 from a negative working capital of approximately ($6,133,000) at March 31, 2011. The most significant factors in the decrease in working capital noted above were the collection of a $200,000 note receivable and an increase in notes payable of approximately $395,000 and in accounts payable of approximately $326,000, which were partially offset by our $183,367 receivable related to the DARPA contract and the increase in our cash position of approximately $339,000 noted above.

In addition to the funds received to date under the DARPA contract and the fundings under the bridge financing and beyond additional billings under the DARPA contract, we will require additional capital as our current financial resources, while improved, remain insufficient to fund our working capital and other cash requirements for the remainder of our fiscal year ending March 31, 2012. Therefore we will be required to seek additional funds through debt and/or equity financing arrangements to finance our current and long-term operations. We are currently addressing our liquidity needs by exploring investment capital opportunities through the private placement of common stock or issuance of additional debt, including the remaining portion of the bridge financing. We believe that our access to additional capital, together with existing cash resources, will be sufficient to meet our short term liquidity needs for fiscal 2012. However, no assurance can be given that we will receive any funds in connection with our capital raising efforts on terms acceptable to the Company, if at all.

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

Subject to the availability of working capital and to fundings under the DARPA contract, we anticipate continuing to increase spending on research and development over the next 12 months. Additionally, associated with our anticipated increase in research and development expenditures, we anticipate purchasing additional amounts of equipment during this period to support our laboratory and testing operations. Operations to date have consumed substantial capital without generating revenues, although the DARPA funding in the December 2011 quarter represents our first revenues, and will continue to require substantial and increasing capital funds to conduct necessary research and development and pre-clinical and clinical testing of our Hemopurifier(R) products, as well as market any of those products that receive regulatory approval. We do not expect to generate revenue from operations for the foreseeable future, and our ability to meet our cash obligations as they become due and payable is dependent for at least the next several years on our ability to sell securities, borrow funds or a combination thereof. Future capital requirements will depend upon many factors, including progress with pre-clinical testing and clinical trials, the number and breadth of our clinical programs, the time and costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other proprietary rights, the time and costs involved in obtaining regulatory approvals, competing technological and market developments, as well as our ability to establish collaborative arrangements, effective commercialization, marketing activities and other arrangements. We expect to continue to incur increasing negative cash flows and net losses for the foreseeable future, and presently require a minimum of $180,000 per month to sustain operations.

At the date of this filing, we plan to invest significantly into purchases of our raw materials and into our contract manufacturing arrangement subject to successfully raising additional capital.

CRITICAL ACCOUNTING POLICIES

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Such estimates and assumptions affect the reported amounts of expenses during the reporting period. On an ongoing basis, we evaluate estimates and assumptions based upon historical experience and various other factors and circumstances. We believe our estimates and assumptions are reasonable in the circumstances; however, actual results may differ from these estimates under different future conditions.

We believe that the estimates and assumptions that are most important to the portrayal of our financial condition and results of operations, in that they require 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 measurement of stock purchase warrants issued with notes payable, beneficial conversion feature of convertible notes payable, impairment of intangible assets, stock compensation, the classification of warrant obligations and evaluation of contingencies.

With the exception of revenue recognition matters, our critical accounting policies have not changed since filing of our annual report on Form 10-K for the year ended March 31, 2011. 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 our future financial condition or results of operations.

With respect to revenue recognition, we entered into a contract with DARPA as discussed above and have recognized revenue during the three months ended December 31, 2011 of $958,075 under such contract. We adopted the Milestone method of revenue recognition for the DARPA contract under ASC 605-28 “Revenue Recognition – Milestone Method” and we believe we meet the requirements under ASC 605-28 for reporting contract revenue under the Milestone Method for the quarter ended December 31, 2011.

In order to account for this contract, the Company identifies the deliverables included within the contract and evaluates which deliverables represent separate units of accounting based on if certain criteria are met, including whether the delivered element has standalone value to the collaborator. The consideration received is allocated among the separate units of accounting, and the applicable revenue recognition criteria are applied to each of the separate units.

A milestone is an event having all of the following characteristics:

(1) There is substantive uncertainty at the date the arrangement is entered into that the event will be achieved. A vendor’s assessment that it expects to achieve a milestone does not necessarily mean that there is not substantive uncertainty associated with achieving the milestone.

(2) The event can only be achieved based in whole or in part on either: (a) the vendor’s performance; or (b) a specific outcome resulting from the vendor’s performance.

(3) If achieved, the event would result in additional payments being due to the vendor.

A milestone does not include events for which the occurrence is either: (a) contingent solely upon the passage of time; or (b) the result of a counterparty’s performance.

The policy for recognizing deliverable consideration contingent upon achievement of a milestone must be applied consistently to similar deliverables.

The assessment of whether a milestone is substantive is performed at the inception of the arrangement. The consideration earned from the achievement of a milestone must meet all of the following for the milestone to be considered substantive:

(1) The consideration is commensurate with either: (a) the vendor's performance to achieve the milestone; or (b) the enhancement of the value of the delivered item or items as a result of a specific outcome resulting from the vendor's performance to achieve the milestone;

(2) The consideration relates solely to past performance; and

(3) The consideration is reasonable relative to all of the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

A milestone is not considered substantive if any portion of the associated milestone consideration relates to the remaining deliverables in the unit of accounting (i.e., it does not relate solely to past performance). To recognize the milestone consideration in its entirety as revenue in the period in which the milestone is achieved, the milestone must be substantive in its entirety. Milestone consideration cannot be bifurcated into substantive and nonsubstantive components. In addition, if a portion of the consideration earned from achieving a milestone may be refunded or adjusted based on future performance, the related milestone is not considered substantive.

OFF-BALANCE SHEET ARRANGEMENTS

We have no obligations required to be disclosed herein as off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

As a Smaller Reporting Company as defined by rule 12b-2 of the Exchange Act and in Item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this item.

ITEM 4. CONTROLS AND PROCEDURES.

DISCLOSURE CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of a date as of the end of the period covered by this Quarterly Report.

Based on such evaluation, our CEO and CFO concluded that, as of the end of such period, our disclosure controls and procedures are not effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and are not effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes in our internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, claims are made against us in the ordinary course of business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting us from selling one or more products or engaging in other activities.

The occurrence of an unfavorable outcome in any specific period could have a material adverse effect on our results of operations for that period or future periods. Other than as set forth here, we are not presently a party to any pending or threatened legal proceedings.

ITEM 1A. RISK FACTORS.

As a Smaller Reporting Company as defined by rule 12b-2 of the Exchange Act and in Item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this item.

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

During the quarter ended December 31, 2011, we issued the following securities which were not registered under the Securities Act of 1933, as amended, and have not been included previously in a Current Report on Form 8-K. We did not employ any form of general solicitation or advertising in connection with the offer and sale of the securities described below. In addition, we believe the purchasers of the securities are "ACCREDITED INVESTORS" for the purpose of Rule 501 of the Securities Act. For these reasons, among others, the offer and sale of the following securities were made in reliance on the exemption from registration provided by Section 4(2) of the Securities Act or Regulation D promulgated by the SEC under the Securities Act:

During the three months ended December 31, 2011, we issued 7,036,702 shares of restricted common stock to holders of notes issued by the Company in exchange for the partial or full conversion of principal and interest of several convertible notes payable in an aggregate amount of $337,999 at an average conversion price of $0.05 per share based upon the conversion formulae in the respective notes.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

As of the date of this report, various promissory and convertible notes payable in the aggregate principal amount of $1,792,210 have reached maturity and are past due. We are continually reviewing other financing arrangements to retire all past due notes. At December 31, 2011, we had accrued interest in the amount of $639,958 associated with these notes and accrued liabilities payable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION.

(a) None.

(b) There have been no changes to the procedures by which security holders may recommend nominees to our board of directors.

ITEM 6. EXHIBITS.

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

3.1	Articles of Incorporation of Aethlon Medical, Inc., as amended (1)
3.2	Bylaws of Aethlon Medical, Inc. (1)
10.1	Form of Subscription Agreement dated November 10, 2011 (2)
10.2	Form of OID Debenture dated November 10, 2011 (2)
10.3	Form of Common Stock Purchase Warrant dated November 10, 2011 (2)
31.1	Certification of Principal Executive 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*
31.2	Certification of Principal 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*
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002*
101	Interactive Data Files

* Filed herewith.

(1) Incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2009.

(2) Incorporated by reference to the filing of such exhibit with the Company’s Quarterly Report on Form 10-Q dated November 18, 2011.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AETHLON MEDICAL, INC.

Date: February 16, 2012 By: /s/ JAMES B. FRAKES
JAMES B. FRAKES
CHIEF FINANCIAL OFFICER
CHIEF ACCOUNTING OFFICER