AETHLON MEDICAL INC
Form 10KSB/A
September 10, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB/A
AMENDMENT NO. 1 TO FORM KSB

(MARK ONE)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2004

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For transition period from _____ to _____

COMMISSION FILE NUMBER 0-21846

AETHLON MEDICAL, INC.

(Name of Small Business issuer in its charter)

NEVADA	13-3632859
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3030 Bunker Hill Street, Suite 4000, San Diego, CALIFORNIA	92109
(Address of principal executive office)	(Zip Code)

ISSUER'S TELEPHONE NUMBER (858) 459-7800

SECURITIES REGISTERED UNDER SECTION 12(B) OF THE EXCHANGE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
NONE	NONE

SECURITIES REGISTERED UNDER SECTION 12(G) OF THE EXCHANGE ACT:

COMMON STOCK--$.001 PAR VALUE
(TITLE OF CLASS)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter

period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.[ ]

Revenues of the registrant for the fiscal year ended March 31, 2004 were $0.

The aggregate market value of the Common Stock held by non-affiliates was approximately $4,502,469 based upon the closing price of the Common Stock of $0.50, as reported by the NASDAQ Over-the-Counter Bulletin Board ("OTCBB") on August 30, 2004.

The number of shares of the Common Stock of the registrant outstanding as of August 20, 2004 was 13,453,550.

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT (CHECK ONE):

Yes [ ] No [X]

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FORWARD - LOOKING STATEMENTS

All statements, other than statements of historical fact, included in this Form 10-KSB/A 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 Securities Exchange Act of 1934 (the "Exchange Act"). The safe harbor for forward looking statements provided by the Private Securities Litigation Reform Act of 1995 does not apply to us. We note, however, that 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. ("Aethlon Medical", "We" 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-KSB/A. Such potential risks and uncertainties include, without limitation, Food and Drug Administration ("FDA") and other regulatory approval of our products, patent protection on 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. Each forward-looking statement should be read in context with, and with an understanding of, the various other disclosures concerning our Company and our business made elsewhere in this annual report as well as other public reports filed with the Securities and Exchange Commission. The forward-looking statements are made as of the date of this Form 10-KSB/A, 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.

PART I

ITEM 1. BUSINESS

GENERAL

Aethlon Medical, Inc. ("Aethlon Medical" "We" or the "Company"), formerly Bishop Equities, Inc. ("Bishop"), was incorporated in Nevada in April 1991 to provide a public vehicle for participation in a business transaction through a merger with or acquisition of a private company. In March 1993, we successfully offered our common stock at $6.00 per share through an initial public offering. In March 1999, Bishop began doing business as "Aethlon Medical, Inc." In March 2000, the Company's Articles of Incorporation were amended to formally change the name of the Company from "Bishop Equities, Inc." to "Aethlon Medical, Inc."

BUSINESS DEVELOPMENT/ACQUISITIONS

On March 10, 1999, (1) Aethlon, Inc., a California corporation ("Aethlon"), (2) Hemex, Inc., a Delaware corporation ("Hemex"), the accounting predecessor to the Company, and (3) Bishop, a publicly traded "shell" company, completed an Agreement and Plan of Reorganization (the "Plan") structured to result in Bishop's acquisition of all of the outstanding common shares of

Aethlon and Hemex (the "Reorganization"). The Reorganization was intended to qualify as a tax-free transaction under Section 368 (a)(1)(B) of the 1986 Internal Revenue Code, as amended. Under the Plan's terms, Bishop issued 733,500 and 1,350,000 shares of its common stock to the common stock shareholders of Aethlon and Hemex, respectively, such that Bishop then owned 100% of each company.

Effective January 1, 2000, we entered into an agreement with Dr. Julian Ambrus, the son of Dr. Clara Ambrus who was the original founder of Hemex, Inc. Under this agreement, an invention and related patent rights for a method of removing HIV and other viruses from the blood were assigned to us. This invention further expands the established blood filtration patents already owned by us. In addition to certain royalty payments equal to 8.75% of net sales of the patented product, the consideration for the acquired rights included the additional issuance of shares of our common stock to the inventors upon the issuance of the patent. The term of the agreement expires on the expiration date of the patents or any patent applications filed in connection with the invention. There have been no sales of the patented product as of August 25, 2004. We initially issued 12,500 shares of restricted common stock to the inventors upon the execution of the agreement. On March 4, 2003, the related patent was issued and we issued 196,078 shares of restricted common stock to the inventors.

On January 10, 2000, we acquired all the outstanding common stock of Syngen Research, Inc. ("Syngen") in exchange for 65,000 shares of our common stock in order to establish research facilities in San Diego, California, as well as employ Dr. Richard Tullis, the founder of Syngen. Dr. Tullis is a recognized research scientist in the area of DNA synthesis and antisense. Syngen had no significant assets, liabilities, or operations, and primarily served as the entity through which Dr. Tullis performed research consulting services. As such, the acquisition has been accounted for as an acquisition of assets in the form of an employment contract with Dr. Tullis and not as a business combination. Dr. Tullis was appointed to the Board of Directors of Aethlon Medical and was elected its Vice President for Business Development. Effective June 1, 2001, Dr. Tullis was appointed Chief Scientific Officer of Aethlon Medical, replacing Dr. Clara Ambrus, who retired from the Company.

On April 6, 2000, we completed the acquisition of Cell Activation, Inc. ("Cell"). In accordance with the purchase agreement, we issued 99,152 shares of restricted common stock and issued 50,148 options to purchase common stock in exchange for all of the outstanding common shares and options to purchase common stock of Cell. After the transaction, Cell became our wholly-owned subsidiary. The acquisition was accounted for as a purchase. At March 31, 2001, we determined that goodwill recognized in the purchase of Cell was impaired due to the permanent suspension of operations by Cell, and, accordingly, treated the related goodwill as fully impaired.

BUSINESS OF ISSUER

We are a development stage therapeutic device company focused on expanding the applications of our Hemopurifier (TM) platform technology, which is designed to rapidly reduce the presence of infectious viruses and other toxins from human blood. In this regard, our core focus is the development of therapeutic devices that treat HIV/AIDS, Hepatitis-C, and pathogens targeted as potential biological warfare agents. In pre-clinical testing, we have published that our HIV-Hemopurifier removed 55% of HIV from human blood in three hours and in excess of 85% of HIV in twelve hours. Additionally, the HIV-Hemopurifier captured 90% of gp120, a toxic protein that depletes human immune cells, during

a one-hour pre-clinical blood study. We have also published pre-clinical blood studies of its HCV-Hemopurifier, which documented the ability to capture 58% of the Hepatitis-C virus from infected blood in two hours. Our potential customers may not accept our interpretation of results from our test sites until our customers repeat the tests and independently verify the tests. Since inception, our only source of revenue has been grants from certain agencies of the Federal Government, subcontract revenue and sale of research and development. No grant revenues have been received after 1999. Since then, from time to time, we have applied for, but have not been awarded, any such grants. Since our current focus is to develop, test and obtain approval of our products, we do not expect to obtain subcontract revenue, nor do we expect to sell our research and development expertise. Any future income derived from grant submissions is likely to be the primary source of revenues until such time that our Hemopurifier has been approved for sale in the marketplace.

THE HEMOPURIFIER(TM)

The Hemopurifier(TM) is an expansive platform technology that converges the established scientific principles of affinity chromatography (method of selective capture of proteins, sugars, fats and organic compounds) and hemodialysis (artificial kidneys) as a means to augment the natural immune response of clearing infectious viruses and toxins from the blood before cells and organs can be infected. The therapeutic goal of each Hemopurifier(TM) application is to improve patient survival rates by reducing viral load and preserving the immune function. We feel that the Hemopurifier(TM) will enhance and prolong the benefit of current infectious disease drug therapies, and fill the void for patients who inevitably become resistant to drug therapies. The Hemopurifier(TM) is also being positioned to treat patients that might become infected by a biological agent with no established drug or vaccine treatment.

Traditionally, hemodialysis has been used to remove urea and other small metabolic toxins that build up in the blood of patients with acute or chronic kidney failure. Acute renal failure is generally handled in the intensive care unit using continuous renal replacement therapy (CRRT) while chronic renal is treated using intermittent, thrice-weekly hemodialysis (IHD) in a stand-alone dialysis clinic.

While there are several variations of technique, a catheter is most often the primary method utilized to gain access to the blood, which is then pumped through a hollow-fiber hemodialysis cartridge. Within the cartridge, toxic salts, urea and excess water pass through small pores in the walls of the hollow-fibers and are removed. Proteins and blood cells that are too large to pass through the membrane are retained. The purified blood is then returned back into circulation.

There are two issues in kidney dialysis as it is practiced today that limit its application to a wide array of toxins and pathogens. Both issues are related to the separation membranes. First, hemodialysis cartridges non-selectively remove substances of a particular size from the blood. Thus in addition to removing toxins, the dialyzer may also remove important substances that the body would prefer to retain. Second, many important toxins are too large pass through the dialysis membrane and are therefore not removed even when it would be desirable.

We have solved these problems by designing a Hemopurifier(TM) cartridge which has pores large enough to let the largest toxins pass through (i.e. particles as large as whole viruses), yet selective enough to remove only the

targeted toxins. Materials such as antibodies, which bind only to their corresponding antigen, provide selectivity, while the use of a sealed cartridge allows the process to use large pore sizes that are normally incompatible with kidney dialysis.

The binding antibodies or other selective agents are chemically bound to the surface of glass or plastic beads located on the outside of the hollow-fibers. This effectively prevents the active materials from entering the bloodstream. Viruses and toxins in the blood diffuse or are transported through the pores in the hollow-fibers and become trapped by the immobilized antibody.

In this way, materials of very large sizes are allowed enter the cartridge while non-toxic materials of similar size readily leave and re-enter the bloodstream. Blood cells and platelets, which are too large to enter the membrane, remain in the hollow-fiber and are returned to the patient. Importantly, the Hemopurifier(TM) cartridge does not require the development of any new equipment. The cartridge fits directly onto the global infrastructure of dialysis machines already located in hospitals and clinics.

INFECTIOUS DISEASE

The current treatment for viral illnesses include vaccines and antiviral drugs. Vaccines have been the most successful in curing viral diseases (e.g. polio and smallpox). Unfortunately, newly emerging pathogens (e.g. SARS), highly mutable RNA viruses (e.g. HIV and Hepatitis C virus) and exotic viruses that might be used in terrorist attacks often do not have vaccine treatments. Similarly, antiviral drugs are often useful in controlling viral infections. However, there do not seem to be any general, broad-spectrum antiviral agents similar to penicillin for bacteria and viruses capable of rapidly developing drug resistant mutations. In addition, it generally takes years and millions of dollars to develop vaccine and drug candidates that may or may not be approved by the FDA.

Our Hemopurifier(TM) technology represents a new approach to treating viral diseases. The treatment is designed to work with current treatments to remove infectious virus, toxic viral proteins and injurious immunological mediators directly from the blood of the patient. By removing circulating virus and toxins from the blood, the Hemopurifier(TM) cartridge prevents virus from infecting unaffected tissues and cells, thereby allowing the body's natural defenses a chance to recover and reject the disease.

BIOLOGICAL WEAPONS

On January 29, 2004, we announced that it we are developing treatments to combat infectious agents that may be used in biological warfare and terrorism. This expands our intent to treat infectious diseases beyond HIV/AIDS and Hepatitis-C. We are working to design Hemopurifiers(TM) that can be rapidly deployed by armed forces as wearable post-exposure treatments on the battlefield, as well as dialysis-based treatments for civilian populations. We are focusing our bio-defense strategy on treating "Category A" agents, which are considered by the Centers for Disease Control (CDC) to be the worst bioterror threats. These agents include the viruses that cause Smallpox, hemorrhagic fevers such as Ebola and Marburg, the Anthrax bacteria, and Botulinum toxin which is a gangrene toxin. Each treatment device will be based on the same proprietary Hemopurifier(TM) filtration technology that is utilized in advancing our HIV/AIDS, and Hepatitis-C treatments. We have not yet published any data related to the treatment of any "Category A" agent.

Viral and bacterial illnesses have always been with us and have sometimes been used as weapons. In recent times, some nations have refined and weaponized several pathogens for use in warfare. Although there are specific differences between bioweapons grade organisms in the way they are transmitted or how they are designed to kill, nearly all result in sepsis.

Sepsis is essentially a dysregulation of the immune system, often described as a septic shock. Microbial invasion sets off an immunological chain reaction mediated by proteins produced by cells and tissues. Overexpression of these protein immunological mediators "confuses" the immune system, ultimately resulting in major organ failure and death. Hemodialysis has been used for many years as a treatment in septic shock, which is generally acknowledged to be beneficial. Unfortunately, the technique is limited in the size of the toxins is can remove and inherently non-selective, making it less than completely effective.

Our Hemopurifier(TM) is capable of selectively targeting specific immune mediators responsible for shock and returning the system to functional levels. At the same time, our Hemopurifier(TM) can remove viral and bacterial fragments or toxins that are too large to be removed by normal hemodialysis. Thus, our Hemopurifier(TM) adds the capability of removing the antigens that are responsible for generating immune mediator production in the first place, effectively removing the source of the problem.

Perhaps just as important is the speed with which new treatment options can be developed. Each new bioweapon comes without a corresponding treatment. Typical biowarfare pathogens have been genetically engineered to contain genes that make them resistant to available drugs and vaccines. This presents a substantial problem since the development of new drugs or vaccines usually takes several years. However, our Hemopurifier(TM), when targeted to the new pathogen can often be constructed within a matter of a few months. All that is required is the existence of an antibody or binding protein that selectively adheres to the surface of the target pathogen or toxin. In this regard, our Hemopurifier(TM) is positioned as a rapid response countermeasure against untreatable pathogens that are released as biowarfare agents.

On March 4, 2004, we announced that we have entered into a cooperative agreement with the National Center for Biodefense (NCBD) at George Mason University in Manassas, Virginia. The purpose of the agreement is to broaden scientific resources, and jointly pursue business and funding opportunities within the federal government. Under the terms of the agreement, each party will contribute to the preparation of proposals. One party will be designated as having the primary responsibility for the preparation of all technical and non-technical aspects of the proposal including but not limited to (i) marketing and promotional effort, (ii) proposal content, assembly and production, (iii) liaison with government customer personnel, and (iv) oral discussions and negotiations, if held. The party designated as the subcontractor shall contribute to the preparation of the proposal to the extent necessary to assure the inclusion of a thorough and accurate description of its responsibilities to the proposed project. We will each bear our own expenses for our own performance of proposal and related work under the cooperative agreement. There are proprietary data provisions which prohibit George Mason University and us from using certain information other than in the submission of proposals to government agencies or reports that must be submitted in connection with George Mason University's performance. The duration of the agreement last until earliest of the following events to occur:

a) The failure or inability of either party to provide the support for the preparation of identified proposal opportunities.

b) Mutual consent of the parties to terminate the agreement.

c) Lapse of 24 months from the effective date of this agreement without award of a contract to support one or more projects unless procurement is still open.

d) The indictment, suspension, or debarment by the federal government of either party.

e) A receiver, trustee in bankruptcy or other custodian of the property or assets of a party hereto is appointed, or if either party hereto commits an act of bankruptcy or is adjudicated bankrupt or insolvent.

f) During the term of the agreement, it is determined that either party may be ineligible for award due to a conflict of interest.

MANUFACTURING

We plan to manufacture a small number of cartridges sufficient to complete clinical trials in our current facilities. Ultimately we will outsource cartridge manufacturing to a GMP/ISO9001 compliant contract manufacturer. Hemopurifiers(TM) to treat pathogens that are bioweapons candidates will be sold directly to the U.S. military and the federal government. Sale of Hempurifiers to treat HIV and Hepatitis C will be directed through organizations with established distribution channels.

TREATMENT CLASSIFICATION

Aethlon Medical's treatments for infectious diseases are classified as "IMMUNOTHERAPIES" that augment or mimic the immune system's response of clearing infectious virus, and as "ENTRY INHIBITORS" that curb the re-infection process by physically removing infectious viruses before healthy cells are infected.

Immunotherapy - The "Immunotherapy" classification is a result of our ability to mimic the immune system's natural response of generating antibodies to fight foreign invaders such as viruses. Antibodies are specifically created by the immune system to attach themselves to the antigens (chemical compounds which cause antibodies to be produced e.g. proteins and other component parts of viruses), forming an antigen-antibody complex which neutralizes the invader. The neutralized antigens are then physically removed from the bloodstream by organs such as the liver.

Our treatment technology uses a hemodialysis cartridge (e.g. artificial kidney or plasmapheresis cartridge) modified to contain immobilized antibodies targeted against specific viruses. Plasmapheresis cartridges are utilized to separate blood plasma from blood cells in treating various diseases. Viruses in the blood are captured inside the cartridge through the formation of an antigen-antibody complex, physically removing the virus from circulation. As a result, the physical elimination of infectious virus occurs without the side-effects common in drug therapy.

Entry Inhibitor - Our treatment technology is also classified as an "Entry Inhibitor" since the re-infection process is interrupted when viruses are removed from circulation before cells can be infected. As a result, the replication cycle is inhibited as infectious virus is denied entry into the cells that it seeks to kill. From a therapeutic standpoint, entry inhibitors represent a departure from the traditional drug action of inhibiting viral

replication within the cells that have already been infected. The novel therapeutic mechanism offered by "Entry Inhibitors", combined with the high level of treatment resistance to currently approved drugs, positions "Entry Inhibitors" as an important new treatment strategy to assist HIV/AIDS and Hepatitis-C infected individuals in managing their disease.

Heavy Metal Treatments

Historically, the original Hemopurifier(TM) treatment applications were developed to treat individuals burdened with heavy metal intoxicants. Products developed in this category include treatments for iron overload, aluminum intoxication, lead poisoning, and cisplatin removal. Cisplatin is a platinum compound used to treat cancers but can be toxic in large amounts. The plan to commercialize the iron and aluminum applications of the Hemopurifier(TM) were discontinued when our research and development activities were realigned. In fiscal year 2001, we realigned our research and development activities from developing Hemopurifiers(TM) to treat harmful metals to developing Hemopurifiers(TM) for the treatment of HIV/AIDS and Hepatitis-C. Additionally, our management changed as the board of directors appointed Mr. Joyce to replace Mr. Barry as the President and CEO in June of 2001. We are not currently pursuing the commercialization of these products as we are focused on developing infectious disease related Hemopurifiers(TM).

RESEARCH AND DEVELOPMENT

In fiscal year 2001, we realigned our research and development activities from developing Hemopurifiers(TM) to treat harmful metals to developing Hemopurifiers(TM) for the treatment of HIV/AIDS and Hepatitis-C. As a result of this strategic realignment, we initiated the consolidation of all scientific and administrative functions into our San Diego facilities during the fourth quarter of fiscal 2001. This consolidation was completed during the first quarter of fiscal 2002 and our facilities in Buffalo, N.Y. were closed. In 2004, we expanded our research effort to include the development of Hemopurifiers(TM) as countermeasures against biological weapons.

The cost of research and development, all of which has been charged to operations, amounted to approximately $400,000 over the last two fiscal years.

PATENTS

Effective January 1, 2000, we entered into an agreement with a related party under which an invention and related patent rights for a method of removing HIV and other viruses from the blood using the Hemopurifier(TM) were assigned to us by the inventors in exchange for a royalty to be paid on future sales of the patented product or process and shares of our common stock. On March 4, 2003, the related patent was issued and we issued 196,078 shares of restricted common stock. We have applied for and obtained several patents relating to our HIV-Hemopurifier(TM) and related technology. Any resulting medical device or process will require approval by the FDA, and we have not yet begun efforts to obtain FDA approval on any infectious disease related Hemopurifier(TM). Since many of our patents were issued in the 1980's, they may expire before FDA approval, if any, is obtained. However, we believe that certain patent applications filed and/or other patents issued more recently will help to protect the proprietary nature of the Hemopurifier(TM) treatment technology. The Hemopurifier(TM) is protected by seven issued patents in the United States, Europe and Japan. Three additional patent applications deal with treatments for virus infection and manufacturing methods. The following is a list of patents and patent applications we currently hold. Patent Issuance #7

below, and application #9 are exclusively licensed to us.

ISSUED PATENTS:

1. Ambrus CA and Horvath C (1986) Removing heavy metal ions from blood. USA No. 4,612,122 (Issued September 16, 1986).

2. Ambrus CA and Horvath C (1986) Removing heavy metal ions from blood. Europe No. 0,073,888 (Issued April 23, 1986).

3. Ambrus CA and Horvath C (1986) Removing heavy metal ions from blood. Japan No: 110,047/82 (Issued June 7, 1994).

4. Ambrus CA and Horvath C (1987) Blood purification. US Patent No. 4,714,556 (Issued December 22, 1987)

5. Ambrus CA and Horvath C (1988) Blood purification. US Patent No. 4,787,974 (Issued November 29, 1988)

6. Ambrus CA and Stadler A (2000) Process for immobilizing a chelator on silica device containing immobilized chelator and use thereof. US Patent 6,071,412 (June 6, 2000).

7. Ambrus JL and Scammurra D (2003) Method for removing HIV and other viruses from blood. US Patent 6,528,057 (issued March 4, 2003);

PATENT APPLICATIONS:

8. Ambrus CA and Stadler A (2000) Process for immobilizing a chelator on silica device containing immobilized chelator and use thereof. International Application PCT/US99/17125

9. Ambrus JL and Scamurra D (2003) Method for removing HIV and other viruses from blood. International Application PCT/US99/19448 (filed August 30, 1999)

10. Tullis, R.H. (2003) Lectin affinity hemodialysis method for removal of HIV other viruses from blood. US Patent Application, filed January 3, 2003.

The issued patents cover a range of applications of the Hemopurifier(TM) and variations thereof. The initial applications (Ambrus and Horvath, 1986 and related issues) refer to methods and constructions for removing heavy metals from blood. The U.S. patent will expire on September 16, 2006. The Japanese patent will expire on June 7, 2011. The European patent expired on April 23rd of 2003.

Ambrus and Horvath (1987 and 1988) refer to methods and constructions for using modified hollow-fiber dialysis devices for removing antigenically reactive substances from blood (e.g. antibodies, antigens, toxins and pathogens such as bacteria or viruses). These patents will expire on March 13, 2005 and October 22, 2007, respectively.

Ambrus and Stadler (2000) refers to improved methods for attaching chelators to glass beads (silica) in order to more efficiently remove heavy metals (e.g. iron, lead and aluminum). This patent will expire on July 27, 2018. Ambrus and

Scammura (2003) is a patent that speaks to the removal of viruses and viral fragments from the blood of infected patients using a modified hollow-fiber dialysis device. This patent will expire in March 5, 2019. The European application is ongoing.

Tullis R.H. (2003) is a patent application that covers the use of lectins as an improved means of removing HIV and other viruses from blood. This patent is not yet issued.

INDUSTRY

The industry for treating infectious disease is extremely competitive, and companies developing new treatment procedures are faced with severe regulatory challenges. In this regard, only a small percentage of companies that are developing new treatments will actually obtain approval from the FDA to market their treatments in the United States. Currently, the market for treating HIV/AIDS and Hepatitis-C (HCV) is comprised of drugs designed to reduce viral load by inhibiting viral replication or by inhibiting viruses from infecting healthy cells. Unfortunately, these drugs are toxic, they are expensive to develop, and inevitably, infected patients will develop viral strains that become resistant to drug treatment. As a result, patients are left without treatment options.

COMPETITION

We are advancing our Hemopurifier(TM) technology as a treatment to enhance and prolong current drug therapies by removing the viral strains that cause drug resistance. The Hemopurifier(TM) is also designed to prolong life for infected patients who have become drug resistant and have no other treatment options. Therefore, we do not believe that the Hemopurifier(TM) competes with the current drug therapy treatment standard. However, if the industry considered the Hemopurifier(TM) to be a potential replacement for drug therapy, then the marketplace for the Hemopurifier would be extremely competitive. We are also pursuing the development of Hemopurifiers(TM) to be utilized as treatment countermeasures against biological weapons. In this regard, we are targeting the treatment of pathogens in which current treatments are either limited or do not exist. We believe that we are the sole developer of viral filtration systems (Hemopurifiers(TM)) to treat HIV-AIDS, Hepatitis-C, and Biological weapons.

GOVERNMENT REGULATION

Our activities and products are significantly regulated by a number of governmental entities, including the FDA in the United States. These entities regulate, among other things, the manufacture, testing, safety, effectiveness, labeling, documentation, advertising and sale of our future commercial products. We must obtain regulatory approval for a product in all of these areas before we can commercialize the product. Product development within this regulatory framework takes a number of years and involves the expenditure of substantial resources. Many products that initially appear promising ultimately do not reach the market because they are found to be unsafe or ineffective when tested. Our inability to commercialize a product would impair our ability to earn future revenues.

In the United States, vaccines and immunotherapeutics for human use are subject to FDA approval as "biologics" under the Public Health Service Act and "drugs" under the Federal Food, Drug and Cosmetic Act. The steps required before a new product can be commercialized include: pre-clinical studies in animals, clinical trials in humans to determine safety and efficacy and FDA approval of the product for commercial sale.

Data obtained at any stage of testing is susceptible to varying interpretations, which could delay, limit or prevent regulatory approval.

Moreover, during the regulatory process, new or changed drug approval policies may cause unanticipated delays or rejection of our product. We may not obtain necessary regulatory approvals within a reasonable period of time, if at all, or avoid delays or other problems in testing our products. Moreover, even if we received regulatory approval for a product, the approval may require limitations on use, which could restrict the size of the potential market for the product.

A product's safety and effectiveness in one test is not necessarily indicative of its safety and effectiveness in another test. Moreover, we may not discover all potential problems with a product even after completing testing on it. Some of our products and technologies have undergone only pre-clinical testing. As a result, we do not know whether they are safe or effective for humans. Also, regulatory authorities may decide, contrary to our findings that a product is unsafe or not as effective in actual use as its test results indicated. This could prevent the product's widespread use, require its withdrawal from the market or expose us to liability.

The FDA requires that the manufacturing facility that produces a licensed product meet specified standards, undergo an inspection and obtain an establishment license prior to commercial marketing. Subsequent discovery of previously unknown problems with a product or its manufacturing process may result in restrictions on the product or the manufacturer, including withdrawal of the product from the market. Failure to comply with the applicable regulatory requirements can result in fines, suspensions of regulatory approvals, product recalls, operating restrictions and criminal prosecution.

We have completed preclinical studies that demonstrate the removal of HIV and Hepatitis C virus from infected human blood. We are now in the process of developing our manufacturing protocols and seeking to obtain regulatory approval from the FDA to initiate clinical trials. The following outline references an anticipated clinical path required to obtain market clearance from the FDA so that we can begin sales of the Hemopurifier(TM) within the United States.

For HIV and Hepatitis C Virus treatment

- Animal Safety Trials - complete July 1, 2005
- IDE Submission and FDA Approval for Human Safety Trial - November 1, 2005
- Human Safety Trial - 90-120 days - complete February 1, 2006
- FDA Market Clearance - complete July 1, 2006

For Biodefense applications

- Animal Trials - complete April 1, 2005
- IDE Submission and FDA Approval for Human Safety Trial - July, 2005
  oHuman Safety Trial - 90-120 days - complete November 1, 2005
- FDA Market Clearance - complete April 15, 2006

We have estimated the direct costs for performing the proposed submissions and clinical tests on the timetable given at $5,001,465 through the end of 2005.

Because we may market our products abroad, we will be subject to varying foreign regulatory requirements. Although international efforts are being made to harmonize these requirements, applications must currently be made in each country. The data necessary and the review time varies significantly from one country to another. Approval by the FDA does not ensure approval by the regulatory bodies of other countries.

Any future collaborators will also be subject to all of the above-described regulations in connection with the commercialization of products utilizing our technology.

PRODUCT LIABILITY

The risk of product liability claims, product recalls and associated adverse publicity is inherent in the testing, manufacturing, marketing and sale of medical products. We do not have clinical trial liability insurance coverage. There can be no assurance that future insurance coverage will to be adequate or available. We may not be able to secure product liability insurance coverage on acceptable terms or at reasonable costs when needed. Any liability for mandatory damages could exceed the amount of our coverage. A successful product liability claim against us could require us to pay a substantial monetary award. Moreover, a product recall could generate substantial negative publicity about our products and business and inhibit or prevent commercialization of other future product candidates.

SUBSIDIARIES

We have four dormant wholly-owned subsidiaries, Aethlon, Inc., Cell Activation, Inc., Syngen Research, Inc., and Hemex, Inc.

EMPLOYEES

At March 31, 2004, we had two full-time employees, comprised of our Chief Executive Officer and our Chief Science Officer. Subsequently, as of September 7, 2004, we have added additional full-time employees comprised of our Director of Administrative Services, a research scientist, a research associate and our senior bioengineer and a molecular biologist. We utilize, whenever appropriate, contract and part time professionals in order to conserve cash and resources. We believe that our employee relations are good. None of our employees is represented by a collective bargaining unit.

WHERE YOU CAN FIND MORE INFORMATION

We file annual reports on Form 10-KSB, quarterly reports on Form 10-QSB, current reports on Form 8-K and proxy and information statements and amendments to reports files or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended. The public may read and copy these materials at the SEC's Public Reference Room at 450 Fifth St NW, Washington, DC 20549. The public may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding other companies, like us, that file materials with the SEC electronically. Our headquarters are located at 3030 Bunker Hill Street, Suite 4000, San Diego, CA 92109. Our phone number at that address is (858) 459-7800. Our website is www.aethlonmedical.com.

ITEM 2. DESCRIPTION OF PROPERTY

We currently rent approximately 3,200 square feet of executive office space and laboratory space at 3030 Bunker Hill Street, Suite 4000, San Diego, California 92109 at the rate of $7,520 per month on a lease that expires on July 12, 2006.

ITEM 3. LEGAL PROCEEDINGS

We may be involved from time to time in various claims, lawsuits, disputes with third parties or breach of contract actions incidental to the normal course of business operations. We are currently not involved in any such litigation or any pending legal proceedings that we believe could have a material adverse effect on our financial position or results of operations.

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

None

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

LIMITED PUBLIC MARKET FOR SHARES OF COMMON STOCK

Our Common Stock is quoted on the OTCBB. Our trading symbol is "AEMD." Our Common Stock has had a limited and sporadic trading history.

The following table sets forth for the calendar period indicated the quarterly high and low bid prices for our Common Stock as reported by the OTCBB. The prices represent quotations between dealers, without adjustment for retail markup, mark down or commission, and do not necessarily represent actual transactions.

	HIGH	LOW
2004		
2nd Quarter	$ 1.70	$ 0.54
1st Quarter	$ 4.25	$ 0.37
2003		
4th Quarter	$ 0.55	$ 0.36
3rd Quarter	$ 1.01	$ 0.25
2nd Quarter	$ 0.60	$ 0.20
1st Quarter	$ 0.56	$ 0.15
2002		
4th Quarter	$ 0.85	$ 0.15
3rd Quarter	$ 1.05	$ 0.65
2nd Quarter	$ 1.95	$ 0.55
1st Quarter	$ 2.30	$ 1.15

We have not declared any cash dividends on our common stock since inception and do not anticipate any in the future. Our current business plan is to retain any future earnings to finance the expansion and development of our business. Any future determination to pay cash dividends will be at the discretion of our board of directors, and will be dependent upon our financial condition, results of operations, capital requirements and other factors our board may deem relevant at that time.

There are approximately 800 record holders of our Common Stock at August 20, 2004. The number of registered shareholders includes any beneficial owners of common shares held in street name.

The transfer agent and registrar for our common stock is Computershare Trust Company, located in Denver, Colorado.

PENNY STOCK

Until our shares qualify for inclusion in the NASDAQ system, the public trading, if any, of our common stock will be on the OTC Bulletin Board. As a result, an investor may find it more difficult to dispose of, or to obtain accurate quotations as to the price of, our common stock offered. Our common stock is subject to provisions of Section 15(g) and Rule 15g-9 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), commonly referred to as the "penny stock rule." Section 15(g) sets forth certain requirements for transactions in penny stocks, and Rule 15g-9(d) incorporates the definition of "penny stock" that is found in Rule 3a51-1 of the Exchange Act. The SEC generally defines "penny stock" to be any equity security that has a market price less than $5.00 per share, subject to certain exceptions. If our common stock is deemed to be a penny stock, trading in the shares will be subject to additional sales practice requirements on broker-dealers who sell penny stock to persons other than established customers and accredited investors. "Accredited investors" are persons with assets in excess of $1,000,000 or annual income exceeding $200,000 or $300,000 together with their spouse. For transactions covered by these rules, broker-dealers must make a special suitability determination for the purchase of such security and must have the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the first transaction, of a risk disclosure document, prepared by the SEC, relating to the penny stock market. A broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, and current quotations for the securities. Finally, monthly statements must be sent disclosing recent price information for the penny stocks held in an account and information on the limited market in penny stocks. Consequently, these rules may restrict the ability of a broker-dealer to trade and/or maintain a market in our common stock and may affect the ability of our shareholders to sell their shares.

RECENT SALES OF UNREGISTERED SECURITIES

We have sold or issued the following securities not registered under the Securities Act in reliance upon the exemption from registration pursuant to Section 4(2) of the Securities Act or Regulation D of the Securities Act during the three year period ending on the date of filing of this registration statement. Except as stated below, no underwriting discounts or commissions were payable with respect to any of the following transactions.

CONVERTIBLE DEBT

In April 2003, we issued a 9% convertible note in the amount of $150,000 issued to Ms. Jill Brodersen, an accredited investor. The note was convertible at $0.25 until June 30, 2003, at which time the conversion feature expired. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In March 2004, we issued a 10% convertible note to RP Capital, LLC, an

accredited investor, in the amount of $50,000 for cash. The note was due on April 30, 2004 and was converted at $0.44 per share in May 2004. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

COMMON STOCK AND WARRANTS

In April 2003, we issued 600,000 shares of restricted common stock at a price of $0.25 per share for cash totaling $150,000 to Mr. Rod Tompkins, an accredited individual investor. In connection with the issuance of these shares, we granted Mr. Tompkins 600,000 warrants to purchase our common stock at $0.25 per share. The warrants vested immediately and expire in April 2005. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In May 2003, we issued 40,000 shares of restricted common stock at a price of $0.25 per share for cash totaling $10,000 to entities controlled by Mr. Calvin Leung, et al, an accredited individual investor. Mr. Leung is a director of Aethlon Medical, Inc. In connection with the issuance of these shares, we granted the entities 40,000 warrants to purchase common stock of the Company at $0.25 per share. The warrants vested immediately and expire in May 2004. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In May 2003, we issued 10,000 shares of restricted common stock at a price of $0.25 per share for services valued at $2,500 to Comprehensive Communications, an accredited corporate investor. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

In July 2003, we issued 380,000 shares of restricted common stock at prices between $0.25-$0.30 per share for cash totaling $100,000. 100,000 shares of restricted common stock were issued to Mr. John D. Garber, an accredited individual investor, for $30,000 and 280,000 shares of restricted common stock were issued to entities controlled by Calvin Leung, et al, an accredited individual investor, for $70,000. Mr. Leung is a director of Aethlon Medical, Inc. In connection with the issuance of these shares, we granted these stockholders a total of 380,000 warrants to purchase our common stock at amounts and prices equal to their shares and purchase prices herein. The warrants vested immediately and expire in July 2004. These transactions were exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In September 2003, we issued 160,000 shares of restricted common stock at a price of $0.25 per share for cash totaling $40,000 to Mr. Rod Tompkins, an accredited investor. In connection with the issuance of these shares, we granted Mr. Tompkins 160,000 warrants to purchase our common stock at a price of $0.25 per share. The warrants vested immediately and expire in September 2004. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In September 2003, we issued 60,000 shares of restricted common stock for cash totaling $15,000 to entities controlled by Mr. Calvin Leung, an accredited individual investor, in connection with the exercise of 60,000 warrants to purchase our common stock at $0.25 per share. Mr. Leung is a director of Aethlon Medical, Inc. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In October 2003, we issued 80,000 shares of restricted common stock for

cash totaling $20,000 to Mr. Rod Tompkins, an accredited investor, in connection with the exercise of 80,000 warrants to purchase our common stock at $0.25 per share. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In November 2003, we issued 100,000 shares of restricted common stock at a price of $0.25 per share for cash totaling $25,000. 60,000 shares of restricted common stock were sold to Mr. Phillip Ward, an accredited individual investor, and 40,000 were sold to entities controlled by Mr. Calvin Leung, an accredited individual investor. Mr. Leung is a director of Aethlon Medical, Inc. In connection with the issuance of these shares, we granted the stockholders 100,000 warrants to purchase our common stock at a price of $0.25 per share. The warrants vested immediately and expire in November 2004. These transactions were exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In November 2003, we issued 11,017 shares of restricted common stock at a price of $0.50 per share to Mr. Paul Hastings, an accredited individual investor in connection with the conversion of $5,000 of notes payable plus accrued interest. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In November 2003, we issued 100,000 shares of restricted common stock for cash totaling $25,000, in connection with the exercise of 100,000 warrants to purchase our common stock at $0.25 per share. Mr. John D. Garber, an accredited individual investor, exercised 60,000 of the warrants and an entity controlled by Mr. Calvin Leung, an accredited individual investor, exercised 40,000 warrants. Mr. Leung is a director of Aethlon Medical, Inc. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In November 2003, we issued 40,000 shares of restricted common stock for cash totaling $10,000, to entities controlled by Mr. Calvin Leung, an accredited individual investor, in connection with the exercise of 40,000 warrants to purchase our common stock at $0.25 per share. Mr. Leung is a director of Aethlon Medical, Inc. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In December 2003, we issued 20,000 shares of restricted common stock at a price of $0.25 per share for cash totaling $5,000 to two accredited investors. In connection with the issuance of these shares, we granted the stockholders 20,000 warrants to purchase our common stock at a price of $0.25 per share. The warrants vested immediately and expire in December 2004. These transactions were exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In December 2003, we issued 461,667 shares of restricted common stock at a price of $0.25 per share and 461,667 warrants to purchase common stock at an exercise price of $0.25 per share, to Provident Life Sciences Sector Fund, LP, an institutional investor, in connection with the conversion of $100,000 of convertible notes payable plus accrued interest. The warrants vested immediately and are exercisable through December 2004. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In December 2003, we issued 120,000 shares of restricted common stock for cash totaling $30,000, in connection with the exercise of 120,000 warrants to purchase our common stock at $0.25 per share. Mr. John D. Garber, an accredited individual investor, exercised 40,000 of the warrants and Mr. Rod Tompkins, an accredited individual investor, exercised 80,000 of the warrants. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In January 2004, we issued 26,000 shares of restricted common stock at a price of $0.25 per share for cash totaling $6,500 three entities controlled by Mr. Calvin Leung, an accredited investor. Mr. Leung is a director of Aethlon Medical, Inc. In connection with the issuance of these shares, we granted the entities 6,500 warrants to purchase our common stock at a price of $0.25 per share. The warrants vested immediately and expire in January 2005. These transactions were exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In January 2004, we issued 161,334 shares of restricted common stock at a price of $0.25 per share and 161,334 warrants to purchase common stock at an exercise price of $0.25 per share, in connection with the conversion of $35,000 of notes payable plus accrued interest to Mr. Rob Edward, who held $30,000 in notes and Ms. Linda Price, who held $5,000 in notes, both accredited individual investors. The warrants vested immediately and are exercisable through January 2005. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In January 2004, we issued 62,000 shares of restricted common stock at a price of $0.40 per share for services in the amount of approximately $25,000. 50,000 shares of restricted common stock were issued to executives of Innovative Health Solutions who provided consulting on biodefense marketing and 12,000 shares of restricted common stock were issued to Ms. Deborah Porter, a consultant who provided consulting on technical solutions. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

In February 2004, we issued 100,000 shares of restricted common stock for cash totaling $25,000, in connection with the exercise of 100,000 warrants to purchase our common stock at $0.25 per share. Mr. Rod Tompkins, an accredited individual investor, exercised 60,000 of the warrants and an entity controlled by Mr. Calvin Leung, an accredited investor, exercised 40,000 of the warrants. Mr. Leung is a director of Aethlon Medical, Inc. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In February 2004, we issued 139,063 shares of restricted common stock at a price of $0.25 per share and 139,063 warrants to purchase common stock at an exercise price of $0.25 per share, in connection with the conversion of $25,000 of notes payable plus accrued interest to Mr. Robb Newman, an accredited individual investor. The warrants vested immediately and are exercisable through February 2005. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In February 2004, we issued 190,185 shares of restricted common stock at a prices between $0.50 - $0.54 per share for services in the amount of approximately $105,000. 185,185 shares were issued to executives of The Research Works, Inc, who provided research report and investor relations consulting and 5,000 shares were issued to Ms. Cherry Kau, a consultant, for investor relations conference services. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

In March 2004, we issued 125,000 shares of restricted common stock at prices between $0.30 - $1.125 per share to Mr. Phillip Ward 80,000 shares at $0.30, Mr. Lance Hall 40,000 shares at $0.525, Mr. Jonathan LeBaron 5,000 shares at $1.125, all accredited individual investors for cash totaling $50,625. In connection with the issuance of these shares, we granted the stockholders 125,000 warrants, equal in amount and price to their shares, to purchase our

common stock at prices between $0.30 - $1.125 per share. The warrants vested immediately and expire in March 2005. These transactions were exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In March 2004, we issued 80,000 shares of restricted common stock for cash totaling $20,000, in connection with the exercise of 80,000 warrants to purchase our common stock at $0.25 per share to Mr. Rod Tompkins, an accredited investor. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In March 2004, we issued 854,574 shares of restricted common stock at prices between $0.35-$0.65 per share in connection with the conversion of $242,500 of notes payable plus accrued interest. 813,790 of the shares of restricted common stock were issued to LH Financial (Esquire Trade and Finance), an accredited institutional investor, in conjunction with the conversion of $225,000 in principal amount of notes, plus accrued interest, at $0.35 per share, in accordance with their convertible note agreement. 27,059 shares of restricted common stock were issued to Mr. Robert B. Martin for conversion of $12,500 of convertible notes, plus accrued interest at $0.65 per share and 13,725 shares of restricted shares of common stock were issued at $0.42 per share to Ms. Pamella Fine for conversion of $5,000 of convertible notes, plus accrued interest. We issued 40,784 warrants to purchase our common stock at exercise prices ranging from $0.42 (13,725 to Ms. Fine) to $0.65 (27,059 to Mr. Martin) per share. These warrants vested immediately and are exercisable through March 2005. This transaction was exempt from registration pursuant to Regulation D promulgated under the Securities Act of 1933.

In March 2004, we issued 73,529 shares of restricted common stock at a price of $0.34 per share for legal services in the amount of approximately $25,000 to Richardson & Patel, LLP, our corporate counsel. This transaction was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

EQUITY COMPENSATION PLANS

SUMMARY EQUITY COMPENSATION PLAN DATA

The following table sets forth March 31, 2004 information on our equity compensation plans (including the potential effect of debt instruments convertible into common stock) in effect as of that date:

	(a)	(b)	(c)
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)(2)	Weighted-average exercise price of outstanding options, warrants and rights	Number of secu remaining avai for future iss under equity compensation p (excluding sec reflected in c (a))(3)
Equity compensation plans approved by security holders	47,500	$2.75	452,500

Equity compensation plans not approved by security holders (1)	5,121,809	2.29	N/A
Totals	5,169,309	2.32	452,500

(1) The description of the material terms of non-plan issuances of equity instruments is discussed in Notes 4, 5 and 6 to the accompanying consolidated financial statements.

(2) Net of equity instruments forfeited, exercised or expired.

(3) This column does not include 926,475 shares of common stock that remain to be issued under the 2003 Consultant Stock Plan.

2000 STOCK OPTION PLAN

Our 2000 Stock Option Plan (the "Plan"), adopted by us in August 2000, provides for the grant of incentive stock options (ISOs") to our full-time employees (who may also be Directors) and nonstatutory stock options ("NSOs") to non-employee Directors, consultants, customers, vendors or providers of significant services. The exercise price of any ISO may not be less than the fair market value of the Common Stock on the date of grant or, in the case of an optionee who owns more than 10% of the total combined voting power of all classes of our outstanding stock, not be less than 110% of the fair market value on the date of grant. The exercise price, in the case of any NSO, must not be less than 75% of the fair market value of the Common Stock on the date of grant. The amount reserved under the Plan is 500,000 options. At March 31, 2004, we had granted 47,500 options under the Plan, with 452,500 available for future issuance.

2003 CONSULTANT STOCK PLAN

Our 2003 Consultant Stock Plan (the "Stock Plan"), adopted by us in August 2003, advances our interests by helping us obtain and retain the services of persons providing consulting services upon whose judgment, initiative, efforts and/or services we are substantially dependent, by offering to or providing those persons with incentives or inducements affording such persons an opportunity to become owners of our capital stock. Consultants or advisors are eligible to receive grants under the plan program only if they are natural persons providing bona fide consulting services to us, with the exception of any services they may render in connection with the offer and sale of our securities in a capital-raising transaction, or which may directly or indirectly promote or maintain a market for our securities.

We reserved a total of 1,000,000 common shares for issuance under the Stock Plan. The Stock Plan provides for the grants of common stock. No awards may be issued after the ten year anniversary of the date we adopted the Stock Plan, the termination date for the plan.

On March 29, 2004, we filed with the SEC a registration statement on Form S-8 for the purpose of registering 1,000,000 common shares issuable under the Stock Plan under the Securities Act of 1933.

STAND-ALONE GRANTS

From time to time our board of directors grants common share purchase options or warrants to selected directors, officers, employees, consultants and advisors in payment of goods or services provided by such persons on a stand-alone basis outside of any of our formal stock plans. The terms of these grants are individually negotiated.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis should be read in conjunction with the consolidated Financial Statements and Notes thereto appearing elsewhere in this report.

Certain statements contained herein that are not related to historical results, including, without limitation, statements regarding the Company's business strategy and objectives, future financial position, expectations about pending litigation and estimated cost savings, are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act") and involve risks and uncertainties. Although we believe that the assumptions on which these forward-looking statements are based are reasonable, there can be no assurance that such assumptions will prove to be accurate and actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, regulatory policies, competition from other similar businesses, and market and general economic factors. All forward-looking statements contained in this Form 10-KSB are qualified in their entirety by this statement.

PLAN OF OPERATION

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

We plan to continue our research and development activities related to our Hemopurifier(TM) platform technology, with particular emphasis on the advancement of our lead product candidates for the treatment of HIV/AIDS. We plan to continue our pre-clinical trials for both our HIV/AIDS Hemopurifier(TM) products as well as for our biodefense Hemopurifier(TM) products. We plan to start small human clinical trials for HIV patients in fiscal 2005. We also plan to implement a regulatory strategy for the use of our Hemopurifier(TM) for biodefense treatments in fiscal 2005 pursuant to a recent rule implemented by the FDA for medical countermeasures to weapons of mass destruction. Under this rule, in situations where it is deemed unethical to conduct efficacy studies in humans, a treatment can be reviewed for approval on the basis of efficacy in the most relevant animal species and safety data in humans.

We expect to add approximately seven additional employees in the next twelve months, associated with our expanded research and development effort that will include expanding our goal beyond treating infectious diseases HIV/AID and Hepatitis-C and new applications to combat infectious agents that may be used in biological warfare and terrorism. This will involve designing Hemopurifier(TM) products that can be rapidly deployed by armed forces as wearable post-exposure treatments on the battlefield, as well as dialysis-based treatments for civilian populations. This will entail developing the new treatment device based on the same proprietary Hemopurifier(TM) filtration technology that is utilized in

advancing our HIV/AIDS, and Hepatitis-C treatments. An important part of this will include our cooperative agreement with the National Center for Biodefense at George Mason to jointly pursue business and funding opportunities within the federal government.

Accordingly, due to this increase in activity during the next twelve months, we anticipate increasing our spending on research and development during the next twelve months. Additionally, associated with our anticipated increase in research and development expenditures, we anticipate purchasing significant amounts of equipment and tenant improvements, during this period to support our laboratory and testing operations.

Our operations to date have consumed substantial capital without generating revenues, and we will continue to require substantial and increasing capital funds to conduct necessary research and development and pre-clinical and clinical testing of our Hemopurifier(TM) products, and to market any of those products that receive regulatory approval. We do not expect to generate revenue from operations for the foreseeable future, and our ability to meet our cash obligations as they become due and payable is expected to depend for at least the next several years on our ability to sell securities, borrow funds or a combination thereof. Our future capital requirements will depend upon many factors, including progress with pre-clinical testing and clinical trials, the number and breadth of our programs, the time and costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other proprietary rights, the time and costs involved in obtaining regulatory approvals, competing technological and market developments, and our ability to establish collaborative arrangements, effective commercialization, marketing activities and other arrangements. We expect to continue to incur increasing negative cash flows and net losses for the foreseeable future.

We recorded a consolidated net loss of $(1,518,798) or ($0.19) per share and $(2,361,116) or ($0.43) per share for the fiscal years ended March 31, 2004 and 2003, respectively.

Our consolidated operating expenses for fiscal 2004 were $995,549 versus $1,871,385 for fiscal 2003. This decrease in operating expenses of $875,836 or 46.8% is largely attributable to a reduction in our professional fees by $321,162, or 48.6%, principally due to lower investor relations fees, lower patent royalty fees, and lower legal, accounting, technical and other professional services; lower payroll by $132,231, or 24%, principally due to fewer full time executive and administrative personnel and lower general and administrative expenses in the amount of $88,245, or 27% due to lower insurance and warrant costs all totaling $641,532, and the absence of the patent impairment charge of $234,304 incurred in fiscal 2003. Our capital equipment expenditures were insignificant in fiscal 2003 and 2002.

In fiscal year 2003, we incurred non-cash expenses in the amount of $234,304 related to the impairment of the carrying value of patents pending. We capitalize the cost of patents and patents pending, some of which were acquired, and amortize such costs over the shorter of the remaining legal life or their estimated economic life, upon issuance of the patent. We write off unamortized cost of patents and patents pending when we determine there is no future benefit.

In fiscal year 2003, we also incurred non-cash expenses in the amount of $114,000 related to options granted to a consultant. These expenses represented a significant portion of the professional fees that we incurred during fiscal 2003.

Our current plan of operation is to fund our anticipated increased research and development activities and operations for the near future through the $673,000 private placement of common stock and the common stock purchase agreement with Fusion Capital Fund II, LLC ("Fusion Capital") in May 2004, whereby Fusion Capital has committed to buy up to an additional $6,000,000 of our common stock over a 30-month period, commencing, at our election, after the Securities and Exchange Commission has declared effective a registration statement covering such shares. However, no assurance can be given that we will receive any additional funds under our agreement with Fusion Capital. Based on our projections of additional employees for operations and to complete research, development and testing associated with our Hemopurifier(TM) products, we anticipate that these funds will satisfy our cash requirements, including this anticipated increase in operations, in excess of the next twelve months. However, due to market conditions, and to assure availability of funding for operations in the long term, we may arrange for additional funding, subject to acceptable terms, during the next twelve months.

GOING CONCERN

Our independent registered public accounting firm has stated in their audit report on the Company's March 31, 2004 consolidated financial statements, that we have a working capital deficit and a significant deficit accumulated during the development stage. These conditions, among others, raise substantial doubt about our ability to continue as a going concern.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires us to make judgments, assumptions and estimates that affect the amounts reported in the consolidated financial statements and the accompanying notes. The amounts of assets and liabilities reported on our balance sheet and the amounts of revenues and expenses reported for each of our fiscal periods are affected by estimates and assumptions, which are used for, but not limited to, the accounting for the issuance of convertible notes payable and various equity instruments. Actual results could differ from these estimates. The following critical accounting policies are significantly affected by judgments, assumptions and estimates used in the preparation of the financial statements:

ACCOUNTING FOR TRANSACTIONS INVOLVING STOCK COMPENSATION

Financial Accounting Standards Board ("FASB") Interpretation No. 44 ("FIN 44"), "ACCOUNTING FOR CERTAIN TRANSACTIONS INVOLVING STOCK COMPENSATION, AN INTERPRETATION OF APB 25" clarifies the application of APB 25 for (a) the definition of employee for purposes of applying APB 25, (b) the criteria for determining whether a plan qualifies as a noncompensatory plan, (c) the accounting consequence for various modifications to the terms of a previously fixed stock option or award, and (d) the accounting for an exchange of stock compensation awards in a business combination. FIN 44 is effective July 1, 2000, but certain provisions cover specific events that occur after either December 15, 1998, or January 12, 2000.

Under Accounting Principles Board Opinion No. 25, "ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES," compensation expense is the excess, if any, of the estimated fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Compensation expense, if any, is recognized over the applicable service period, which is usually the

vesting period.

Statement of Financial Accounting Standards ("SFAS") 123, "ACCOUNTING FOR STOCK-BASED COMPENSATION," if fully adopted, changes the method of accounting for employee stock-based compensation plans to the fair value based method. For stock options and warrants, fair value is estimated using an option pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option or warrant, stock volatility and the annual rate of quarterly dividends. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period. The adoption of the accounting methodology of SFAS 123 is optional and the Company has elected to continue accounting for stock-based compensation issued to employees using APB 25; however, pro forma disclosures, as the Company adopted the cost recognition requirement under SFAS 123, are required to be presented.

SFAS 148, "ACCOUNTING FOR STOCK-BASED COMPENSATION - TRANSITION AND DISCLOSURE, AN AMENDMENT OF FASB STATEMENT NO. 123," was issued in December 2002 and is effective for fiscal years ending after December 15, 2002. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

STOCK PURCHASE WARRANTS ISSUED WITH NOTES PAYABLE

The Company granted warrants in connection with the issuance of certain notes payable. Under Accounting Principles Board Opinion No. 14, " ACCOUNTING FOR CONVERTIBLE DEBT AND DEBT ISSUED WITH STOCK PURCHASE WARRANTS," the relative estimated fair value of such warrants represents a discount from the face amount of the notes payable.

BENEFICIAL CONVERSION FEATURE OF CONVERTIBLE NOTES PAYABLE

The convertible feature of certain notes payable provides for a rate of conversion that is below market value. Such feature is normally characterized as a "beneficial conversion feature" ("BCF"). Pursuant to Emerging Issues Task Force Issue No. 98-5 ("EITF Issue No. 98-5"), "ACCOUNTING FOR CONVERTIBLE SECURITIES WITH BENEFICIAL CONVERSION FEATURES OR CONTINGENTLY ADJUSTABLE CONVERSION RATIO" and Emerging Issues Task Force Issue No. 00-27, " APPLICATION OF EITF ISSUE NO. 98-5 TO CERTAIN CONVERTIBLE INSTRUMENTS," the estimated fair value of the BCF is recorded in the consolidated financial statements as a discount from the face amount of the notes. Such discounts are amortized to interest expense over the term of the notes.

IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS

SFAS 144, "ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF" addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If the cost basis of a long-lived asset is greater than the projected future undiscounted net cash flows from such asset (excluding interest), an impairment loss is recognized. Impairment losses are calculated as the difference between the cost basis of an asset and its estimated fair value. SFAS 144 also requires

companies to separately report discontinued operations and extends that reporting requirement to a component of an entity that either has been disposed of (by sale, abandonment or in a distribution to owners) or is classified as held for sale. Assets to be disposed of are reported at the lower of the carrying amount or the estimated fair value less costs to sell. The Company adopted SFAS 144 on January 1, 2002. The provisions of this pronouncement relating to assets held for sale or other disposal generally are required to be applied prospectively after the adoption date to newly initiated commitments to plan to sell or dispose of such asset, as defined, by management. As a result, management cannot determine the potential effects that adoption of SFAS 144 will have on the Company's financial statements with respect to future disposal decisions, if any. Management believes no impairment exists at March 31, 2004.

INCOME TAXES

Under SFAS 109, "ACCOUNTING FOR INCOME TAXES," deferred tax assets and liabilities are recognized for the future tax consequences attributable to the difference between the consolidated financial statements and their respective tax basis. Deferred income taxes reflect the net tax effects of (a) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts reported for income tax purposes, and (b) tax credit carryforwards. The Company records a valuation allowance for deferred income tax assets when, based on management's best estimate of taxable income in the foreseeable future, it is more likely than not that some portion of the deferred income tax assets may not be realized.

OFF-BALANCE SHEET ARRANGEMENTS

We have not entered into any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources and would be considered material to investors.

RISK FACTORS

We have described below a number of uncertainties and risks which, in addition to uncertainties and risks presented elsewhere in this annual report, may adversely affect our business, operating results and financial condition. The uncertainties and risks enumerated below as well as those presented elsewhere in this annual report should be considered carefully in evaluating our company and our business and the value of our securities.

RISKS RELATING TO OUR BUSINESS

WE HAVE ACCUMULATED LOSSES SINCE OUR INCEPTION, AND CURRENTLY HAVE NO PRODUCTS OR SERVICES ON THE MARKET THAT ARE CURRENTLY GENERATING REVENUES.

Our inability to generate revenues and profits from products we have recently introduced onto the market could cause us to go out of business and for you to lose your entire investment. We have not had any revenues for the past three years. To date, we have engaged primarily in research, development and clinical testing. Since our inception, we have not been profitable, and we cannot be certain that we will ever achieve or sustain profitability. We have incurred a cumulative net loss in the amount of $17,045,313 from our inception through March 31, 2004. We have no products or services on the market that are currently generating revenues. Our failure to generate meaningful revenues and

ultimately profits from potential products and applications of our technology could force us to reduce or suspend our operations and ultimately go out of business. Developing our product candidates will require significant additional research and development, including non-clinical testing and clinical trials, as well as regulatory approval. We expect these activities, together with our general and administrative expenses, to result in operating losses for the foreseeable future.

WE HAVE RECEIVED AN OPINION FROM OUR AUDITORS REGARDING OUR ABILITY TO CONTINUE AS A GOING CONCERN

Our independent auditors noted in their report accompanying our financial statements for our fiscal year ended March 31, 2004 that we had net losses since our inception, had a working capital deficit and that a significant amount of additional capital will be necessary to advance the development of our products to the point at which we may become commercially viable and stated that those conditions raised substantial doubt about our ability to continue as a going concern. Note 1 to our financial statements addressed management's plans to address these matters. We cannot assure you that our business plans will be successful in addressing these issues. This opinion about our ability to continue as a going concern could affect our ability to obtain additional financing at favorable terms, if at all, as such an opinion may cause investors to lose faith in our long term prospects. If we cannot successfully continue as a going concern, our shareholders may lose their entire investment in our common shares.

WE MAY FAIL TO OBTAIN GOVERNMENT CONTRACTS TO DEVELOP OUR HEMOPURIFIER(TM) TECHNOLOGY FOR BIODEFENSE APPLICATIONS.

The U.S. Government has undertaken commitments to help secure improved countermeasures against bioterrorism. We have submitted two Small Business Innovative Research grant proposals, one in 2002 and the other in April 2004, with the National Institutes of Health that relate to the use of our Hemopurifier(TM) as a countermeasure treatment against certain biological weapons and anticipate submitting further proposals on U.S. Government contracts. We have not had any material discussions with the National Institutes of Health. The Hemopurifier(TM) has not been approved for use by any government agency, nor have we received any contracts to purchase the Hemopurifier(TM). Since inception, we have not generated revenues from the sale of any product based on our Hemopurifier(TM) technology platform. The process of obtaining government contracts is lengthy and uncertain and we must compete for each contract. Accordingly, we cannot be certain that we will be awarded any future government contracts utilizing our Hemopurifier(TM) platform technology. If the U.S. Government makes significant future contract awards to our competitors our business will be harmed.

In addition, the determination of when and whether a product is ready for large scale purchase and potential use will be made by the government through consultation with a number of governmental agencies, including the Food and Drug Administration (the "FDA"), the National Institutes of Health, the Centers for Disease Control and Prevention and the Department of Homeland Security.

IF THE U.S. GOVERNMENT FAILS TO PURCHASE SUFFICIENT QUANTITIES OF ANY FUTURE BIODEFENSE CANDIDATE UTILIZING OUR HEMOPURIFIER(TM) PLATFORM TECHNOLOGY, WE MAY BE UNABLE TO GENERATE SUFFICIENT REVENUES TO CONTINUE OPERATIONS.

We cannot be certain of the timing or availability of any future funding from the U.S. Government, and substantial delays or cancellations of funding could result from protests or challenges from third parties once such funding is obtained. If we develop products utilizing our Hemopurifier(TM) platform technology that are approved by the Food and Drug Administration, but

the U.S. Government does not place sufficient orders for these products, our future business will be harmed.

U.S. GOVERNMENT AGENCIES HAVE SPECIAL CONTRACTING REQUIREMENTS, WHICH CREATE ADDITIONAL RISKS.

Our business plan to provide biodefense product candidates and HIV-Hemopurifier(TM) candidates may involve contracts with the U.S. Government. U.S. Government contracts typically contain unfavorable termination provisions and are subject to audit and modification by the government at its sole discretion, which subjects us to additional risks. These risks include the ability of the U.S. Government to unilaterally:

- suspend or prevent us for a period of time from receiving new contracts or extending existing contracts based on violations or suspected violations of laws or regulations;
- audit and object to our contract-related costs and fees, including allocated indirect costs;
- control and potentially prohibit the export of our products; and
- change certain terms and conditions in our contracts.

If we were to become a U.S. Government contractor, we would be required to comply with applicable laws, regulations and standards relating to our accounting practices and would be subject to periodic audits and reviews. As part of any such audit or review, the U.S. Government may review the adequacy of, and our compliance with, our internal control systems and policies, including those relating to our purchasing, property, estimating, compensation and management information systems. Based on the results of its audits, the U.S. Government may adjust our contract-related costs and fees, including allocated indirect costs. In addition, if an audit or review uncovers any improper or illegal activity, we would possibly be subject to civil and criminal penalties and administrative sanctions, including termination of our contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. Government. We could also suffer serious harm to our reputation if allegations of impropriety were made against us. Although adjustments arising from government audits and reviews have not seriously harmed our business in the past, future audits and reviews could cause adverse effects. In addition, under U.S. Government purchasing regulations, some of our costs, including most financing costs, amortization of intangible assets, portions of our research and development costs, and some marketing expenses, would possibly not be reimbursable or allowed under such contracts. Further, as a U.S. Government contractor, we would be subject to an increased risk of investigations, criminal prosecution, civil fraud, whistleblower lawsuits and other legal actions and liabilities to which purely private sector companies are not.

WE WILL FACE INTENSE COMPETITION FROM COMPANIES THAT HAVE GREATER FINANCIAL, PERSONNEL AND RESEARCH AND DEVELOPMENT RESOURCES THAN OURS.

These competitive forces may impact our projected growth and ability to generate revenues and profits, which would have a negative impact on our business and the value of your investment.

Our competitors are developing vaccine candidates, which could compete

with the Hemopurifier(TM) product candidates we are developing. our commercial opportunities will be reduced or eliminated if our competitors develop and market products for any of the diseases that we target that:

- are more effective;
- have fewer or less severe adverse side effects; are better tolerated;
- are more adaptable to various modes of dosing; are easier to administer;
- or are less expensive than the products or product candidates we are developing.

Even if we are successful in developing effective Hemopurifier(TM) products, and obtain FDA and other regulatory approvals necessary for commercializing them, our products may not compete effectively with other successful products. Researchers are continually learning more about diseases, which may lead to new technologies for treatment. Our competitors may succeed in developing and marketing products either that are more effective than those that we may develop, alone or with our collaborators, or that are marketed before any products we develop are marketed.

The Congress' recent passage of the $5.6 billion Project BioShield Bill, a comprehensive effort to develop and make available modern, effective drugs and vaccines to protect against attack by biological and chemical weapons or other dangerous pathogens, may encourage competitors to develop their own product candidates. We cannot predict the decisions that will be made in the future by the various government agencies as a result of such legislation.

Our competitors include fully integrated pharmaceutical companies, biotechnology companies, universities and public and private research institutions. Many of the organizations competing with us, have substantially greater capital resources, larger research and development staffs and facilities, greater experience in product development and in obtaining regulatory approvals, and greater marketing capabilities than we do.

The market for medical devices is intensely competitive. Many of our potential competitors have longer operating histories, greater name recognition, more employees, and significantly greater financial, technical, marketing, public relations, and distribution resources than we have. This intense competitive environment may require us to make changes in our products, pricing, licensing, services or marketing to develop, maintain and extend our current technology. Price concessions or the emergence of other pricing or distribution strategies of competitors may diminish our revenues, adversely impact our margins or lead to a reduction in our market share, any of which may harm our business.

OUR HEMOPURIFER(TM) TECHNOLOGY MAY BECOME OBSOLETE.

Our Hemopurifier(TM) products may be made unmarketable by new scientific or technological developments where new treatment modalities are introduced that are more efficacious or more economical than our Hemopurifier(TM) products. The Homeland Security industry is growing rapidly with many competitors trying to develop products or vaccines to protect against infectious disease. Any one of our competitors could develop a more effective product which would render our technology obsolete.

OUR USE OF HAZARDOUS MATERIALS, CHEMICALS AND VIRUSES REQUIRE US TO COMPLY WITH REGULATORY REQUIREMENTS AND EXPOSES US TO POTENTIAL LIABILITIES.

Our research and development involves the controlled use of hazardous materials, chemicals and viruses. The primary hazardous materials include chemicals needed to construct the Hemopurifier(TM) cartridges and HIV and Hepatitis C infected plasma samples used in preclinical test of the Hemopurifier(TM). All other chemicals are fully inventoried and reported to the appropriate authorities, such as the fire department, who inspect the facility on a regular basis. We are subject to federal, state, local and foreign laws governing the use, manufacture, storage, handling and disposal of such materials. Although we believe that our safety procedures for the use, manufacture, storage, handling and disposal of such materials comply with the standards prescribed by federal, state, local and foreign regulations, we cannot completely eliminate the risk of accidental contamination or injury from these materials. We have had no incidents or problems involving hazardous chemicals or biological samples. In the event of such an accident, we could be held liable for significant damages or fines. We currently do not carry insurance to protect us from these damages. In addition, we may be required to incur significant costs to comply with regulatory requirements in the future.

WE ARE DEPENDENT FOR OUR SUCCESS ON A FEW KEY EXECUTIVE OFFICERS.

Our success depends to a critical extent on the continued services of our Chief Executive Officer, James A. Joyce, our Chief Financial Officer, Edward C. Hall and our Chief Science Officer, Richard H. Tullis. Were we to lose one or more of these key executive officers, we would be forced to expend significant time and money in the pursuit of a replacement, which would result in both a delay in the implementation of our business plan and the diversion of limited working capital. The loss of Dr. Tullis was harm the clinical development of our products due to his unique experience with the Hemopurifier technology. We can give you no assurance that we can find satisfactory replacements for these key executive officers at all, or on terms that are not unduly expensive or burdensome to our company. Although Mr. Joyce and Mr. Tullis have signed employment agreements providing for their continued service to the company, these agreements will not preclude them from leaving the company. Mr. Hall is a part-time employee and his employment is severable by either party upon 30-days notice. We do not currently carry key man life insurance policies on any of our key executive officers which would assist us in recouping our costs in the event of the loss of those officers.

OUR INABILITY TO ATTRACT AND RETAIN QUALIFIED PERSONNEL COULD IMPEDE OUR ABILITY TO GENERATE REVENUES AND PROFITS AND TO OTHERWISE IMPLEMENT OUR BUSINESS PLAN AND GROWTH STRATEGIES, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND COULD ADVERSELY AFFECT THE VALUE OF YOUR INVESTMENT.

We currently have an extremely small staff comprised of seven full time employees consisting of our Chief Executive Officer, our Chief Science Officer, our Director of Administrative Services, a research scientist, a research associate, a senior bioengineer and a molecular biologist as well as other personnel employed on a contract basis. Although we believe that these employees, together with the consultants currently engaged by our company, will be able to handle most of our additional administrative, research and development and business development in the near term, we will nevertheless be required over the longer-term to hire highly skilled managerial, scientific and administrative personnel to fully implement our business plan and growth strategies. We cannot assure you that we will be able to engage the services of

such qualified personnel at competitive prices or at all, particularly given the risks of employment attributable to our limited financial resources and lack of an established track record.

WE PLAN TO GROW VERY RAPIDLY, WHICH WILL PLACE STRAINS ON OUR MANAGEMENT TEAM AND OTHER COMPANY RESOURCES TO BOTH IMPLEMENT MORE SOPHISTICATED MANAGERIAL, OPERATIONAL AND FINANCIAL SYSTEMS, PROCEDURES AND CONTROLS AND TO TRAIN AND MANAGE THE PERSONNEL NECESSARY TO IMPLEMENT THOSE FUNCTIONS. OUR INABILITY TO MANAGE OUR GROWTH COULD IMPEDE OUR ABILITY TO GENERATE REVENUES AND PROFITS AND TO OTHERWISE IMPLEMENT OUR BUSINESS PLAN AND GROWTH STRATEGIES, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND THE VALUE OF YOUR INVESTMENT.

We will need to significantly expand our operations to implement our longer-term business plan and growth strategies. We will also be required to manage multiple relationships with various strategic partners, technology licensors, customers, manufacturers and suppliers, consultants and other third parties. This expansion and these expanded relationships will require us to significantly improve or replace our existing managerial, operational and financial systems, procedures and controls; to improve the coordination between our various corporate functions; and to manage, train, motivate and maintain a growing employee base. The time and costs to effectuate these steps may place a significant strain on our management personnel, systems and resources, particularly given the limited amount of financial resources and skilled employees that may be available at the time. We cannot assure you that we will institute, in a timely manner or at all, the improvements to our managerial, operational and financial systems, procedures and controls necessary to support our anticipated increased levels of operations and to coordinate our various corporate functions, or that we will be able to properly manage, train, motivate and retain our anticipated increased employee base.

WE MAY HAVE DIFFICULTY IN ATTRACTING AND RETAINING MANAGEMENT AND OUTSIDE INDEPENDENT MEMBERS TO OUR BOARD OF DIRECTORS AS A RESULT OF THEIR CONCERNS RELATING TO THEIR INCREASED PERSONAL EXPOSURE TO LAWSUITS AND SHAREHOLDER CLAIMS BY VIRTUE OF HOLDING THESE POSITIONS IN A PUBLICLY-HELD COMPANY.

The directors and management of publicly traded corporations are increasingly concerned with the extent of their personal exposure to lawsuits and shareholder claims, as well as governmental and creditor claims which may be made against them, particularly in view of recent changes in securities laws imposing additional duties, obligations and liabilities on management and directors. Due to these perceived risks, directors and management are also becoming increasingly concerned with the availability of directors and officers liability insurance to pay on a timely basis the costs incurred in defending such claims. We currently do not carry directors and officers liability insurance. Directors and officers liability insurance has recently become much more expensive and difficult to obtain. If we are unable to obtain directors and officers liability insurance at affordable rates or at all, it may become increasingly more difficult to attract and retain qualified outside directors to serve on our board of directors. The fees of directors are also rising in response to their increased duties, obligations and liabilities as well as increased exposure to such risks. As a company with a limited operating history and limited resources, we will have a more difficult time attracting and retaining management and outside independent directors than a more established company due to these enhanced duties, obligations and liabilities.

IF WE FAIL TO COMPLY WITH EXTENSIVE REGULATIONS ENFORCED BY DOMESTIC AND FOREIGN REGULATORY AUTHORITIES, THE COMMERCIALIZATION OF OUR PRODUCT CANDIDATES COULD BE

PREVENTED OR DELAYED.

Our pathogen filtration devices, or Hemopurifier(TM) products, are subject to extensive government regulations related to development, testing, manufacturing and commercialization in the United States and other countries. The determination of when and whether a product is ready for large scale purchase and potential use will be made by the government through consultation with a number of governmental agencies, including the FDA, the National Institutes of Health, the Centers for Disease Control and Prevention and the Department of Homeland Security. Our product candidates are in the pre-clinical and clinical stages of development and have not received required regulatory approval from the FDA to be commercially marketed and sold. The process of obtaining and complying with FDA and other governmental regulatory approvals and regulations is costly, time consuming, uncertain and subject to unanticipated delays. Despite the time and expense exerted, regulatory approval is never guaranteed. We also are subject to the following risks and obligations, among others.

- The FDA may refuse to approve an application if they believe that applicable regulatory criteria are not satisfied.
- The FDA may require additional testing for safety and effectiveness.
- The FDA may interpret data from pre-clinical testing and clinical trials in different ways than we interpret them.
- If regulatory approval of a product is granted, the approval may be limited to specific indications or limited with respect to its distribution.
- The FDA may change their approval policies and/or adopt new regulations.

Failure to comply with these or other regulatory requirements of the FDA may subject us to administrative or judicially imposed sanctions, including:

- warning letters;
- civil penalties;
- criminal penalties;
- injunctions;
- product seizure or detention;
- product recalls; and
- total or partial suspension of productions.

DELAYS IN SUCCESSFULLY COMPLETING OUR CLINICAL TRIALS COULD JEOPARDIZE OUR ABILITY TO OBTAIN REGULATORY APPROVAL OR MARKET OUR HEMOPURIFIER(TM) PRODUCT CANDIDATES ON A TIMELY BASIS.

Our business prospects will depend on our ability to complete clinical trials, obtain satisfactory results, obtain required regulatory approvals and successfully commercialize our Hemopurifier(TM) product candidates. Completion of our clinical trials, announcement of results of the trials and our ability to obtain regulatory approvals could be delayed for a variety of reasons, including:

- serious adverse events related to our vaccine candidates;
- unsatisfactory results of any clinical trial;
- the failure of our principal third-party investigators to perform our clinical trials on our anticipated schedules; and/or
- different interpretations of our pre-clinical and clinical data, which could initially lead to inconclusive results.

OUR DEVELOPMENT COSTS WILL INCREASE IF WE HAVE MATERIAL DELAYS IN ANY CLINICAL TRIAL OR IF WE NEED TO PERFORM MORE OR LARGER CLINICAL TRIALS THAN PLANNED.

If the delays are significant, or if any of our Hemopurifier(TM) product candidates do not prove to be safe or effective or do not receive required regulatory approvals, our financial results and the commercial prospects for our product candidates will be harmed. Furthermore, our inability to complete our clinical trials in a timely manner could jeopardize our ability to obtain regulatory approval.

THE INDEPENDENT CLINICAL INVESTIGATORS THAT WE RELY UPON TO CONDUCT OUR CLINICAL TRIALS MAY NOT BE DILIGENT, CAREFUL OR TIMELY, AND MAY MAKE MISTAKES, IN THE CONDUCT OF OUR CLINICAL TRIALS.

We depend on independent clinical investigators to conduct our clinical trials. The investigators are not our employees, and we cannot control the amount or timing of resources that they devote to our product development programs. If independent investigators fail to devote sufficient time and resources to our product development programs, or if their performance is substandard, it may delay FDA approval of our vaccine candidates. These independent investigators may also have relationships with other commercial entities, some of which may compete with us. If these independent investigators assist our competitors at our expense, it could harm our competitive position.

THE APPROVAL REQUIREMENTS FOR MEDICAL PRODUCTS USED TO FIGHT BIOTERRORISM ARE STILL EVOLVING, AND WE CANNOT BE CERTAIN THAT ANY PRODUCTS WE DEVELOP, IF EFFECTIVE, WOULD MEET THESE REQUIREMENTS.

We are developing product candidates based upon current governmental policies regulating these medical countermeasure treatments. For instance, we intend to pursue FDA approval of our proprietary pathogen filtration devices to treat infectious agents under requirements published by the FDA that allow the FDA to approve certain vaccines used to reduce or prevent the toxicity of chemical, biological, radiological or nuclear substances based on human clinical data to demonstrate safety and immune response, and evidence of effectiveness derived from appropriate animal studies and any additional supporting data. Our business is subject to substantial risk because these policies may change suddenly and unpredictably and in ways that could impair our ability to obtain regulatory approval of these products, and we cannot guarantee that the FDA will approve our proprietary pathogen filtration devices.

OUR PRODUCT DEVELOPMENT EFFORTS MAY NOT YIELD MARKETABLE PRODUCTS DUE TO RESULTS OF STUDIES OR TRIALS, FAILURE TO ACHIEVE REGULATORY APPROVALS OR MARKET ACCEPTANCE, PROPRIETARY RIGHTS OF OTHERS OR MANUFACTURING ISSUES.

Our success depends on our ability to successfully develop and obtain

regulatory approval to market new filtration devices. We expect that a significant portion of the research that we will conduct will involve new and unproven technologies. Development of a product requires substantial technical, financial and human resources even if the product is not successfully completed.

Our previously planned products have not become marketable products due in part to our transition in 2001 from a focus on utilizing our Hemopurifier(TM) technology on treating harmful metals to treating infectious diseases prior to our having completed the FDA approval process. Our transition was made in order to focus on larger markets and too take advantage of the sense of greater sense of urgency surrounding infectious diseases. Our pending products face similar challenges of obtaining successful clinical trials in route to gaining FDA approval prior to commercialization.

Our potential products may appear to be promising at various stages of development yet fail to reach the market for a number of reasons, including the:

- lack of adequate quality or sufficient prevention benefit, or unacceptable safety during pre-clinical studies or clinical trials;
- failure to receive necessary regulatory approvals;
- existence of proprietary rights of third parties; and/or
- inability to develop manufacturing methods that are efficient, cost-effective and capable of meeting stringent regulatory standards.

POLITICAL OR SOCIAL FACTORS MAY DELAY OR IMPAIR OUR ABILITY TO MARKET OUR PRODUCTS.

Products developed to treat diseases caused by or to combat the threat of bioterrorism will be subject to changing political and social environments. The political and social responses to bioterrorism have been highly charged and unpredictable. Political or social pressures may delay or cause resistance to bringing our products to market or limit pricing of our products, which would harm our business. Bioterrorism has become the focus of political debates especially with the upcoming presidential elections, both in terms of how to approach bioterrorism and the amount funding the government should provide for any programs involving homeland protection. Government funding for products on bioterrorism could be reduce which would hinder our ability to obtain governmental grants.

OUR INABILITY TO PROTECT OUR INTELLECTUAL PROPERTY RIGHTS COULD NEGATIVELY IMPACT OUR PROJECTED GROWTH AND ABILITY TO GENERATE REVENUES AND PROFITS, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND THE VALUE OF YOUR INVESTMENT.

We rely on a combination of patent, patent pending, copyright, trademark and trade secret laws, proprietary rights agreements and non-disclosure agreements to protect our intellectual properties. We cannot give you any assurance that these measures will prove to be effective in protecting our intellectual properties.

In the case of patents, we cannot give you any assurance that our existing patents will not be invalidated, that any patents that we currently or prospectively apply for will be granted, or that any of these patents will ultimately provide significant commercial benefits. Further, competing companies

may circumvent any patents that we may hold by developing products which closely emulate but do not infringe our patents. While we intend to seek patent protection for our products in selected foreign countries, those patents may not receive the same degree of protection as they would in the United States. We can give you no assurance that we will be able to successfully defend our patents and proprietary rights in any action we may file for patent infringement. Similarly, we can give you any assurance that we will not be required to defend against litigation involving the patents or proprietary rights of others, or that we will be able to obtain licenses for these rights. Legal and accounting costs relating to prosecuting or defending patent infringement litigation may be substantial. Since many of our patents were issued in the 1980's, they may expire before FDA approval, if any, is obtained. However, we believe that certain patent applications filed and/or other patents issued more recently will help to protect the proprietary nature of the Hemopurifier treatment technology.

The Hemopurifier(TM) is protected by seven issued patents, in the United States, Europe and Japan, six of which we own and one which we own the exclusive license. Three additional patent applications deal with treatments for virus infection and manufacturing methods, two of which we own and one which we own the exclusive license.

We also rely on proprietary designs, technologies, processes and know-how not eligible for patent protection. We cannot give you any assurance that our competitors will not independently develop the same or superior designs, technologies, processes and know-how.

While we have and will continue to enter into proprietary rights agreements with our employees and third parties giving us proprietary rights to certain technology developed by those employees or parties while engaged by our company, we can give you no assurance that courts of competent jurisdiction will enforce those agreements.

THE PATENTS WE OWN COMPRISE A MAJORITY OF OUR ASSETS WHICH COULD LIMIT OUR FINANCIAL VIABILITY.

The Hemopurifier(TM) is protected by seven issued patents, in the United States, Europe and Japan, six of which we own and one which we own the exclusive license. These patents comprise a majority of our assets. If our existing patents are invalidated or if they fail to provide significant commercial benefits, it will severely hurt our financial condition as a majority of our assets would lose their value. Further, since our patents are written down over the course of their term until they expire, our assets comprised of patents will continually be written down until they lose value altogether.

LEGISLATIVE ACTIONS AND POTENTIAL NEW ACCOUNTING PRONOUNCEMENTS ARE LIKELY TO IMPACT OUR FUTURE FINANCIAL POSITION AND RESULTS OF OPERATIONS.

There have been regulatory changes, including the Sarbanes-Oxley Act of 2002, and there may potentially be new accounting pronouncements or additional regulatory rulings which will have an impact on our future financial position and results of operations. The Sarbanes-Oxley Act of 2002 and other rule changes as well as proposed legislative initiatives following the Enron bankruptcy have increased general and administrative costs as we have incurred increased legal and accounting fees to comply with such rule changes. Further, proposed initiatives are expected to result in changes in certain accounting rules, including legislative and other proposals to account for employee stock options as a compensation expense. These and other potential changes could materially increase the expenses we report under generally accepted accounting principles,

and adversely affect our operating results.

OUR PRODUCTS MAY BE SUBJECT TO RECALL OR PRODUCT LIABILITY CLAIMS.

Our Hemopurifier(TM) products may be used in connection with medical procedures in which it is important that those products function with precision and accuracy. If our products do not function as designed, or are designed improperly, we may be forced by regulatory agencies to withdraw such products from the market. In addition, if medical personnel or their patients suffer injury as a result of any failure of our products to function as designed, or an inappropriate design, we may be subject to lawsuits seeking significant compensatory and punitive damages. Any product recall or lawsuit seeking significant monetary damages may have a material affect on our business and financial condition.

RISKS RELATING TO AN INVESTMENT IN OUR SECURITIES

TO DATE, WE HAVE NOT PAID ANY CASH DIVIDENDS AND NO CASH DIVIDENDS WILL BE PAID IN THE FORESEEABLE FUTURE.

We do not anticipate paying cash dividends on our common shares in the foreseeable future, and we cannot assure an investor that funds will be legally available to pay dividends, or that even if the funds are legally available, that the dividends will be paid.

THE APPLICATION OF THE "PENNY STOCK" RULES COULD ADVERSELY AFFECT THE MARKET PRICE OF OUR COMMON SHARES AND INCREASE YOUR TRANSACTION COSTS TO SELL THOSE SHARES.

As long as the trading price of our common shares is below $5 per share, the open-market trading of our common shares will be subject to the "penny stock" rules. The "penny stock" rules impose additional sales practice requirements on broker-dealers who sell securities to persons other than established customers and accredited investors (generally those with assets in excess of $1,000,000 or annual income exceeding $200,000 or $300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of securities and have received the purchaser's written consent to the transaction before the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the broker-dealer must deliver, before the transaction, a disclosure schedule prescribed by the SEC relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative and current quotations for the securities. Finally, monthly statements must be sent disclosing recent price information on the limited market in penny stocks. These additional burdens imposed on broker-dealers may restrict the ability or decrease the willingness of broker-dealers to sell our common shares, and may result in decreased liquidity for our common shares and increased transaction costs for sales and purchases of our common shares as compared to other securities.

OUR COMMON SHARES ARE THINLY TRADED, SO YOU MAY BE UNABLE TO SELL AT OR NEAR ASK PRICES OR AT ALL IF YOU NEED TO SELL YOUR SHARES TO RAISE MONEY OR OTHERWISE DESIRE TO LIQUIDATE YOUR SHARES.

Our common shares have historically been sporadically or "thinly-traded" on the OTCBB, meaning that the number of persons interested in purchasing our common shares at or near ask prices at any given time may be

relatively small or non-existent. As of August 19, 2004, our average trading volume per day for the past three months was approximately 31,000 shares a day with a high of 249,853 shares traded and a low of zero shares traded. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. We cannot give you any assurance that a broader or more active public trading market for our common shares will develop or be sustained, or that current trading levels will be sustained.

In May 2004, Fusion Capital committed to buy up to $6,000,000 of our common stock. (SEE "PLAN OF OPERATIONS"). Fusion Capital's purchase of $10,000 of our common stock each trading day could cause our common stock price to decline due to the additional shares available in the market, particularly in light of the relatively thin trading volume of our common stock. The market price of our common stock could decline and the voting power and value of your investment would be subject to continual dilution if Fusion Capital purchases the shares and resells those shares into the market. Any adverse affect on the market price of our common stock would increase the number of shares issuable to Fusion Capital each trading day which would increase the dilution of your investment. Although we have the right to reduce or suspend Fusion Capital purchases at any time, our financial condition at the time may require us to waive our right to suspend purchases even if there is a decline in the market price. Additionally, up to 2,372,728 shares of our common stock will be registered by other selling shareholders with the shares committed to by Fusion Capital. Sales of large amount of these shares in the public market could substantially depress the prevailing market prices for our shares. If that were to happen, the value of your investment could decline substantially.

Contractual 9.9% beneficial ownership limitations prohibit Fusion Capital, together with its affiliates, from beneficially owning more than 9.9% of our outstanding common stock. This 9.9% limitation does not prevent Fusion Capital from purchasing shares of our common stock and then reselling those shares in stages over time where Fusion Capital and its affiliates do not, at any given time, beneficially own shares in excess of the 9.9% limitation. Consequently, these limitations will not necessarily prevent substantial dilution of the voting power and value of your investment.

WE MAY NOT HAVE ENOUGH AUTHORIZED SHARES TO ISSUE ALL OF THE SHARES ELIGIBLE TO BE SOLD TO FUSION CAPITAL.

Our Articles of Incorporation currently authorize the Board of Directors to issue up to 25,000,000 shares of common stock. As of August 20, 2004, we have 13,453,550 shares of common stock outstanding and common share purchase options and warrants entitling the holders to purchase up to 5,513,749 common shares. Additionally, there are 303,000 shares underlying promissory notes convertible into common stock. Under our agreement with Fusion Capital, we will be registering 7,431,819 shares of our common stock for the daily purchases by Fusion Capital. If Fusion Capital were to purchase all 7,431,810 shares and holders exercised all of the common share purchase options and warrants or converted the promissory notes, we would exceed the number of shares we are authorized to issue. We would need to amend our Articles of Incorporation which could prove costly and would require shareholder approval. Any delay in amending our Articles of Incorporation could harm our business by preventing us from raising capital from the issuance of our common stock or delay the payment of

services via issuance of our common stock.

THE MARKET PRICE FOR OUR COMMON SHARES IS PARTICULARLY VOLATILE GIVEN OUR STATUS AS A RELATIVELY UNKNOWN COMPANY WITH A SMALL AND THINLY-TRADED PUBLIC FLOAT, LIMITED OPERATING HISTORY AND LACK OF REVENUES WHICH COULD LEAD TO WIDE FLUCTUATIONS IN OUR SHARE PRICE. THE PRICE AT WHICH YOU PURCHASE OUR COMMON SHARES MAY NOT BE INDICATIVE OF THE PRICE THAT WILL PREVAIL IN THE TRADING MARKET. YOU MAY BE UNABLE TO SELL YOUR COMMON SHARES AT OR ABOVE YOUR PURCHASE PRICE, WHICH MAY RESULT IN SUBSTANTIAL LOSSES TO YOU.

The market for our common shares is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. In fact, during the 52-week period ended August 19, 2004, the high and low sale prices of a share of our common stock were $4.25 and $0.25, respectively. The volatility in our share price is attributable to a number of factors. First, as noted above, our common shares are sporadically and/or thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our shareholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large number of our common shares are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without adverse impact on its share price. Secondly, we are a speculative or "risky" investment due to our limited operating history and lack of revenues or profits to date, and uncertainty of future market acceptance for our potential products. As a consequence of this enhanced risk, more risk-adverse investors may, under the fear of losing all or most of their investment in the event of negative news or lack of progress, be more inclined to sell their shares on the market more quickly and at greater discounts than would be the case with the stock of a seasoned issuer. The following factors may add to the volatility in the price of our common shares: actual or anticipated variations in our quarterly or annual operating results; acceptance of our proprietary technology as viable method of augmenting the immune response of clearing viruses and toxins from human blood; government regulations, announcements of significant acquisitions, strategic partnerships or joint ventures; our capital commitments; and additions or departures of our key personnel. Many of these factors are beyond our control and may decrease the market price of our common shares, regardless of our operating performance. We cannot make any predictions or projections as to what the prevailing market price for our common shares will be at any time, including as to whether our common shares will sustain their current market prices, or as to what effect that the sale of shares or the availability of common shares for sale at any time will have on the prevailing market price.

Shareholders should be aware that, according to SEC Release No. 34-29093, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include (1) control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer; (2) manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases; (3) boiler room practices involving high-pressure sales tactics and unrealistic price projections by inexperienced sales persons; (4) excessive and undisclosed bid-ask differential and markups by selling broker-dealers; and (5) the wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the resulting inevitable collapse of those prices and with consequent investor losses. Our management is aware of the abuses that have occurred historically in the penny stock market. Although we do not expect

to be in a position to dictate the behavior of the market or of broker-dealers who participate in the market, management will strive within the confines of practical limitations to prevent the described patterns from being established with respect to our securities. The occurrence of these patterns or practices could increase the volatility of our share price.

VOLATILITY IN OUR COMMON SHARE PRICE MAY SUBJECT US TO SECURITIES LITIGATION.

The market for our common shares is characterized by significant price volatility when compared to seasoned issuers, and we expect that our share price will continue to be more volatile than a seasoned issuer for the indefinite future. In the past, plaintiffs have often initiated securities class action litigation against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and liabilities and could divert management's attention and resources.

OUR OFFICERS AND DIRECTORS OWN OR CONTROL APPROXIMATELY 22% (EXCLUDING ALL OPTIONS AND WARRANTS EXERCISABLE WITHIN 60 DAYS OF AUGUST 20, 2004) OF OUR OUTSTANDING COMMON SHARES, WHICH MAY LIMIT THE ABILITY OF YOURSELF OR OTHER SHAREHOLDERS, WHETHER ACTING SINGLY OR TOGETHER, TO PROPOSE OR DIRECT THE MANAGEMENT OR OVERALL DIRECTION OF OUR COMPANY. ADDITIONALLY, THIS CONCENTRATION OF OWNERSHIP COULD DISCOURAGE OR PREVENT A POTENTIAL TAKEOVER OF OUR COMPANY THAT MIGHT OTHERWISE RESULT IN YOU RECEIVING A PREMIUM OVER THE MARKET PRICE FOR YOUR COMMON SHARES.

As of August 20, 2004, our officers and directors beneficially own or control approximately 22% (excluding all options and warrants exercisable within sixty days of August 20, 2004) of our outstanding common shares. These persons will have the ability to control substantially all matters submitted to our shareholders for approval and to control our management and affairs, including extraordinary transactions such as mergers and other changes of corporate control, and going private transactions.

A LARGE NUMBER OF COMMON SHARES ARE ISSUABLE UPON EXERCISE OF OUTSTANDING COMMON SHARE PURCHASE OPTIONS, WARRANTS AND CONVERTIBLE PROMISSORY NOTES. THE EXERCISE OR CONVERSION OF THESE SECURITIES COULD RESULT IN THE SUBSTANTIAL DILUTION OF YOUR INVESTMENT IN TERMS OF YOUR PERCENTAGE OWNERSHIP IN THE COMPANY AS WELL AS THE BOOK VALUE OF YOUR COMMON SHARES. THE SALE OF A LARGE AMOUNT OF COMMON SHARES RECEIVED UPON EXERCISE OF THESE OPTIONS OR WARRANTS ON THE PUBLIC MARKET TO FINANCE THE EXERCISE PRICE OR TO PAY ASSOCIATED INCOME TAXES, OR THE PERCEPTION THAT SUCH SALES COULD OCCUR, COULD SUBSTANTIALLY DEPRESS THE PREVAILING MARKET PRICES FOR OUR SHARES.

As of August 20, 2004, there are outstanding non-variable priced common share purchase options and warrants entitling the holders to purchase 5,513,749 common shares at a weighted average exercise price of $2.10 per share. The exercise price for all of the aforesaid warrants, both variable and non-variable priced, may be less than your cost to acquire our common shares. In the event of the exercise or conversion of these convertible securities, you could suffer substantial dilution of your investment in terms of your percentage ownership in the company as well as the book value of your common shares. In addition, the holders of the common share purchase options or warrants may sell common shares in tandem with their exercise of those options or warrants to finance that exercise, or may resell the shares purchased in order to cover any income tax liabilities that may arise from their exercise of the options or warrants.

OUR ISSUANCE OF ADDITIONAL COMMON SHARES, OR OPTIONS OR WARRANTS TO PURCHASE THOSE SHARES, WOULD DILUTE YOUR PROPORTIONATE OWNERSHIP AND VOTING RIGHTS.

We are entitled under our certificate of incorporation to issue up to 25,000,000 shares of common stock. After taking into consideration our outstanding common stock at August 20, 2004, we will be entitled to issue up to 11,546,450 additional common shares. Our board may generally issue shares of common stock, or options or warrants to purchase those shares, without further approval by our shareholders based upon such factors as our board of directors may deem relevant at that time. It is likely that we will be required to issue a large amount of additional securities to raise capital to further our development. It is also likely that we will be required to issue a large amount of additional securities to directors, officers, employees and consultants as compensatory grants in connection with their services, both in the form of stand-alone grants or under our stock plans. We cannot give you any assurance that we will not issue additional common, or options or warrants to purchase those shares, under circumstances we may deem appropriate at the time.

THE ELIMINATION OF MONETARY LIABILITY AGAINST OUR DIRECTORS, OFFICERS AND EMPLOYEES UNDER OUR CERTIFICATE OF INCORPORATION AND THE EXISTENCE OF INDEMNIFICATION RIGHTS TO OUR DIRECTORS, OFFICERS AND EMPLOYEES MAY RESULT IN SUBSTANTIAL EXPENDITURES BY OUR COMPANY AND MAY DISCOURAGE LAWSUITS AGAINST OUR DIRECTORS, OFFICERS AND EMPLOYEES.

Our certificate of incorporation contains provisions which eliminate the liability of our directors for monetary damages to our company and shareholders. Our bylaws also require us to indemnify our officers and directors. We may also have contractual indemnification obligations under our agreements with our directors, officers and employees. The foregoing indemnification obligations could result in our company incurring substantial expenditures to cover the cost of settlement or damage awards against directors, officers and employees, which we may be unable to recoup. These provisions and resultant costs may also discourage our company from bringing a lawsuit against directors, officers and employees for breaches of their fiduciary duties, and may similarly discourage the filing of derivative litigation by our shareholders against our directors, officers and employees even though such actions, if successful, might otherwise benefit our company and shareholders.

ANTI-TAKEOVER PROVISIONS MAY IMPEDE THE ACQUISITION OF OUR COMPANY.

Certain provisions of the Nevada General Corporation Law have anti-takeover effects and may inhibit a non-negotiated merger or other business combination. These provisions are intended to encourage any person interested in acquiring us to negotiate with, and to obtain the approval of, our Board of Directors in connection with such a transaction. However, certain of these provisions may discourage a future acquisition of us, including an acquisition in which the shareholders might otherwise receive a premium for their shares. As a result, shareholders who might desire to participate in such a transaction may not have the opportunity to do so.

ITEM 7. FINANCIAL STATEMENTS

The financial statements listed in the accompanying Index to Financial Statements are attached hereto and filed as a part of this Report under Item 13.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 8A. EVALUATION OF CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Exchange Act as of a date (the "Evaluation Date") within 90 days prior to filing the Company's March 31, 2004 Form 10-KSB/A. Based upon that evaluation, our CEO and CFO concluded that, as of March 31, 2004, our disclosure controls and procedures were effective in timely alerting management to the material information relating to us (or our consolidated subsidiaries) required to be included in our periodic filings with the SEC. Based on their most recent evaluation as of the Evaluation Date, our CEO and the CFO have also concluded that there are no significant deficiencies in the design or operation of internal controls over financial reporting, at the reasonable assurance level, which are reasonably likely to adversely affect our ability to record, process, summarize and report financial information, and such officers have identified no material weaknesses in our internal controls over financial reporting.

CHANGES IN CONTROLS AND PROCEDURES

There were no significant changes made in our internal controls over financial reporting during the quarter ended March 31, 2004 that have materially affected or are reasonably likely to materially affect these controls. Thus, no corrective actions with regard to significant deficiencies or material weaknesses were necessary.

LIMITATIONS ON THE EFFECTIVENESS OF INTERNAL CONTROL

Our management, including the CEO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material errors. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations on all internal control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Aethlon Medical have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, and/or by management override of the control. The design of any system of internal control is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in circumstances, and/or the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective internal control system, financial reporting misstatements due to error or fraud may occur and not be detected on a timely basis.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Section 16 (a) of the Securities Exchange Act of 1934 requires our officers, directors, and persons who own more than 10% of a registered class of our equity securities to file reports of ownership and changes in ownership with the SEC and Nasdaq. Officers, directors, and greater than 10% beneficial owners are required by SEC regulation to furnish the Company with copies of all Section 16 (a) forms they file. We believe that all filing requirements applicable to its officers, directors, and greater than 10% beneficial owners were complied with.

EXECUTIVE OFFICERS, DIRECTORS AND KEY EMPLOYEES

The names, ages and positions of our directors and executive officers as of August 20, 2004 are listed below:

NAMES	TITLE OR POSITION	AGE
James A. Joyce (1)	Chairman, President, Chief Executive Officer and Secretary	42
Richard H. Tullis, PhD (2)	Vice President, Chief Science Officer and Director	59
Edward C. Hall (3)	Vice President, Chief Financial Officer	63
Franklyn S. Barry, Jr.	Director	64
Edward G. Broenniman	Director	67
Calvin M. Leung (4)	Director	66

(1) Effective June 1, 2001, Mr. Joyce was appointed our President and Chief Executive Officer, replacing Mr. Barry, who continues as a member of the board of directors. Mr. Barry also served as a consultant to us on strategic business issues from June 1, 2001 to May 31, 2003.

(2) Also effective June 1, 2001, Dr. Tullis was appointed as the Company's Chief Science Officer, replacing Dr. Clara M. Ambrus, who retired.

(3) Effective August 14, 2002 Mr. Hall was elected our Vice President and Chief Financial Officer, replacing Robert S. Stefanovich, who resigned July 26, 2002.

(4) Effective June 30, 2003 Mr. Leung was elected to our board of directors.

RESUMES OF MANAGEMENT:

James A. Joyce, Chairman, President and CEO

Mr. Joyce is the founder of Aethlon Medical, and has been the Chairman of the Board and Secretary since March 1999. On June 1, 2001, our Board of Directors appointed Mr. Joyce with the additional roles of President and CEO. In February of 1993, Mr. Joyce founded James Joyce & Associates, an organization that provided management consulting and corporate finance advisory services to CEOs and CFOs of publicly traded companies. Previously, Mr. Joyce was Chief Executive Officer of Mission Labs, Inc., and a principal in charge of U.S. operations for London Zurich Securities, Inc. Mr. Joyce is a graduate from the

University of Maryland.

Edward C. Hall, Vice President, Chief Financial Officer

Mr. Hall has been Vice President, Chief Financial Officer of the Company since August 2002 on a part-time basis. Mr. Hall has held senior financial executive positions with both public and privately-held life sciences and technology companies for over 25 years. Prior to his appointment as Chief Financial Officer of Aethlon Medical, he served as Vice President and Chief Financial Officer of Chromagen, Inc, a private biotech tools company which develops proteomic and genomic assays for use in drug discovery. Prior to that Mr. Hall was Vice President, Finance and Chief Financial Officer of Cytel Corporation, a public biotech company and developer of anti-inflammatory drugs. Prior to that, Mr. Hall was Vice President, Finance and Chief Financial Officer of Medical Device Technologies, a public medical device company. Mr. Hall is also Vice President, Chief Financial Officer of Alliance Pharmaceutical Corp., a public research-based pharmaceutical development company, and he is a Partner of Tatum CFO Partners, LLP.

Richard H. Tullis, Ph.D., Vice President, Chief Science Officer

Dr. Tullis has been Vice President and a director of the Company since January 2000 and Chief Science Officer since June 2001. Dr. Tullis has extensive biotechnology management and research experience, and is the founder of Syngen Research, a wholly-owned subsidiary of Aethlon Medical, Inc. Previously, Dr. Tullis co-founded Molecular Biosystems, Inc., a former NYSE company. At Molecular Biosystems, Dr. Tullis was Director of Research and Development, Director of Oligonucleotide Hybridization, Senior Research Scientist and Member of the Board of Directors. In research, Dr. Tullis developed and patented the first application of oligonucleotides to antisense antibiotics and developed new methods for the chemical synthesis of DNA via methoxy-phosphorochloridites. Dr. Tullis also co-developed the first applications of covalently coupled DNA-enzyme conjugates using synthetic oligonucleotides during his tenure at Molecular Biosystems. In 1985, Dr. Tullis founded, and served as President and CEO of Synthetic Genetics, Inc., a pioneer in custom DNA synthesis, which was sold to Molecular Biology Resources in 1991. Dr. Tullis also served as interim-CEO of Genetic Vectors, Inc., which completed its IPO under his management, and was co-founder of DNA Sciences, Inc., a company that was eventually acquired by Genetic Vectors. Dr Tullis received his Ph.D. in Biochemistry and Cell Biology from the University of California at San Diego, and has done extensive post-doctoral work at UCSD, USC, and The Scripps Research Institute.

Franklyn S. Barry, Jr.

Mr. Barry has over 25 years of experience in managing and building companies. He was President and Chief Executive Officer of Hemex from April 1997 through May 31, 2001 and our President and CEO from March 10, 1999 to May 31, 2001. He became a director of Aethlon Medical on March 10, 1999. From 1994 to April 1997, Mr. Barry was a private consultant. Included among his prior experiences are tenures as President of Fisher-Price and as co-founder and CEO of Software Distribution Services, which today operates as Ingram Micro-D, an international distributor of personal computer products. Mr. Barry serves on the Board of Directors of Merchants Mutual Insurance Company.

Edward G. Broenniman

Mr. Broenniman became a director of Aethlon Medical on March 10, 1999. Mr. Broenniman has 30 years of management and executive experience with high-tech, privately held growth firms where he has served as a CEO, COO, or corporate advisor, using his expertise to focus management on increasing profitability and stockholder value. He is the Managing Director of The Piedmont Group, LLC, a venture advisory firm. Mr. Broenniman recently served on the Board of Directors of publicly traded QuesTech (acquired by CACI International), and currently serves on the Boards of four privately-held firms. His nonprofit Boards are the Dingman Center for Entrepreneurship's Board of Advisors at the University of Maryland, the National Association of Corporate Directors, National Capital Chapter and the Board of the Association for Corporate Growth, National Capital Chapter.

Calvin M. Leung

Mr. Leung became a director of Aethlon Medical on June 30, 2003. He is the President of Mandarin Investment Corporation, specializing in investment, development and management of mobile home and recreational vehicle parks in California, Arizona and the Midwest since 1975. He has syndicated a number of land and housing developments in the western United States.

Mr. Leung, born in Hong Kong, received his advanced education in the United States where he was awarded a doctorate degree in psychology specializing in experimental research. He taught at the university level for several years.

Our Board of Directors has the responsibility for establishing broad corporate policies and for overseeing our overall performance. Members of the Board are kept informed of our business activities through discussions with the President and other officers, by reviewing analyses and reports sent to them, and by participating in board and committee meetings. Our bylaws provide that each of the directors serves for a term that extends to our next Annual Meeting of Shareholders. Our Board of Directors presently has an Audit Committee and a Compensation Committee on each of which Messrs. Barry and Broenniman and Leung serve. Mr. Barry is Chairman of the Audit Committee, and Mr. Broenniman is Chairman of the Compensation Committee.

Non-employee Board members are accruing stock options and cash compensation according to the plan approved in August 2000. Employee directors receive no compensation.

FAMILY RELATIONSHIPS.

There are no family relationships between or among the directors, executive officers or persons nominated or charged by us to become directors or executive officers

There are no arrangements or understandings between any two or more of our directors or executive officers. There is no arrangement or understanding between any of our directors or executive officers and any other person pursuant to which any director or officer was or is to be selected as a director or officer, and there is no arrangement, plan or understanding as to whether non-management shareholders will exercise their voting rights to continue to elect the current board of directors. There are also no arrangements, agreements or understanding between non-management shareholders that may directly or

indirectly participate in or influence the management of our affairs.

REGULATORY AND CLINICAL ADVISOR

Kenneth R. Michael, Pharm.D., R.A.C.

Dr. Michael is the President of KRM Associates LLC, a regulatory and clinical affairs consulting organization. He is the former VP of Regulatory Affairs and Quality Assurance at Siemens Medical Systems, and he is the founder, past President and Chairman of The Regulatory Affairs Professional Society. He is also the founder of the San Diego Regulatory Affairs Network.

SCIENTIFIC ADVISORY BOARD

Each person listed below is a current member of our Science Advisory Board. The role of the Science Advisory Board is to provide scientific guidance related to the development of our Hemopurifier(TM) technology. Unlike the members of our board of directors, the Science Advisory Board members are not involved in the management or operations of our company. Members of the Science Advisory Board are paid $500 per day for services rendered either on-site or at a mutually agreeable location.

Jean-Claude Chermann, Ph.D.

Dr. Chermann is a pioneer in the study of retroviruses, and was the principal investigator of the research team that collaborated in the first isolation and characterization of HIV at the Pasteur Institute in 1983. Dr. Chermann was also the Director of Research of INSERM (French National Institute of Health and Medical Research) and also held the position of Director of Research of Unit INSERM U322 on "Retrovirus and Associated Diseases" from 1989 until June 2001 when he accepted his current role as Chief Scientific Director of Urrma Biopharma based in Montreal, Canada, and Research & Development Director of URRMA R&D, based in Aubagne, France.

Larry Cowgill, D.V.M., Ph.D.

Dr. Cowgill is a Professor in the Department of Medicine and Epidemiology at the School of Veterinary Medicine, University of California--Davis and has nearly 30 years of experience as a clinical instructor in small animal internal medicine, nephrology and hemodialysis. He currently Heads the Companion Animal Hemodialysis Units at the Veterinary Medical Teaching Hospital at UC Davis and the UC Veterinary Medical Center-San Diego. Dr. Cowgill is also Associate Dean for Southern California Clinical Programs and is Co-Director of the University of California Veterinary Medical Center-San Diego. Prior to his appointment at the University of California, he was a National Institutes of Health (NIH) Special Research Fellow at the University of Pennsylvania School of Veterinary Medicine and at the Renal Electrolyte Section at the University of Pennsylvania School of Medicine, where he conducted research in basic renal physiology and clinical nephrology. Dr. Cowgill received his D.V.M. from the University of California--Davis School of Veterinary Medicine and his Ph.D. in Comparative Medical Sciences from the University of Pennsylvania, where he also completed his internship and Residency training in Small Animal Internal Medicine. He became a Diplomat of the American College of Veterinary Internal Medicine in 1977. Dr. Cowgill has published extensively in the area of veterinary nephrology and has established a Clinical Fellowship in

Renal Medicine and Hemodialysis, which is the first of its kind in veterinary Medicine.

Pedro Cuatrecasas, M.D.

Dr. Cuatrecasas was President of the Pharmaceutical Research Division of Parke-Davis Co., and Corporate Vice President for Warner Lambert Company from 1989 until his retirement in 1997. From 1986 to 1989, he served as SVP and Director of Glaxo Inc. For the prior 10 years, he was VP/R&D and Director, of the Burroughs Wellcome Company. During his career in pharmaceutical research, he was involved in the discovery, development and marketing registration of more than 40 novel medicines. Dr. Cuatrecasas is widely recognized for the invention and development of affinity chromatography which is a method for the selective capture of proteins, sugars, fats and inorganic compounds. He is a member of the National Academy of Sciences, The Institute of Medicine, and the American Academy of Arts & Sciences, and he has authored more than 400 original publications.

Nathan W. Levin, M.D.

Dr. Levin is recognized as a leading authority within the hemodialysis industry. He is the Medical and Research Director of the Renal Research Institute, LLC, a joint venture between Fresenius Medical Care - North America and Beth Israel Medical Center, New York. Dr. Levin also serves as Professor of Clinical Medicine at the Albert Einstein College of Medicine.

Raveendran (Ravi) Pottathil, Ph.D.

Dr. Pottathil was the Section Manager for Retroviruses (focus on HIV and HCV) and Tumor markers and PCR diagnostics at Hoffman La Roche from 1985 to 1992. He then co-founded Specialty Biosystems, Inc, a venture of Specialty Labs, one of the largest independent reference laboratories in California. Dr. Pottathil has also advised the World Health Organization's Sexually Transmitted Diseases and Global Vaccination Program. Dr. Pottathil has worked with Dr. Robert Huebner of the NIH in immunology and virology at The Jackson Laboratory, and with Drs. David Lang and Wolfgang Joklik at Duke University on interferons, anti-tumor RNAs and antigenic suppression of tumorigenic retroviruses. Academic positions include: Assistant Professor at the University of Maryland School of Medicine; Associate Professor at the City of Hope Medical Center in Duarte, California where he published extensively with Dr. Pedro Cuatrecasas (one of developers of affinity chromatography); and Adjunct Professor in Cellular and Molecular Biology at Down State Medical Center and Rutgers University. As a virologist and molecular biologist, Dr. Pottathil has over 40 refereed publications to his credit and has been a Director of OncQuest, Inc., GeneQuest, Inc., Specialty Laboratories Asia in Singapore and Specialty Ranbaxy in India. Currently, Dr. Pottathil is the President of AccuDx, Inc. a pharmaceutical diagnostics company he founded in 1996.

Claudio Ronco, M.D.

Dr. Ronco is the Director of the Dialysis and Renal Transplantation Programs of St. Bartolo Hospital in Vicenza, Italy. He has published 17 books on nephrology and dialysis and has written or co-authored over 350 scientific articles. Dr. Ronco also serves on the editorial board of 12 scientific

journals, is a director of three international scientific societies, and is recognized as being instrumental in the introduction of continuous hemofiltration and high flux dialysis in Europe.

Ken Alibek, M.D., Ph.D., D.Sc.

Dr. Alibek is the Executive Director of Education at the National Center for Biodefense at George Mason University (GMU), and is a Distinguished Professor at GMU as well. Dr. Alibek specializes in medical and scientific research dedicated to developing new forms of protection against biological weapons and other infectious diseases.

Formerly, Dr. Alibek was a Soviet Army Colonel, and served as First Deputy Chief of the civilian branch of the Soviet Union's biological weapons program until he defected to the United States in 1992 and subsequently served as a consultant to numerous U.S. government agencies in the areas of medical microbiology, biological weapons defense, and biological weapons nonproliferation. Dr. Alibek has worked with the National Institutes of Health, testified extensively before the U.S. Congress on nonproliferation of biological weapons and is the author of Biohazard: The Chilling True Story of the Largest Covert Biological Weapons Program in the World--Told from Inside by the Man Who Ran It, published by Random House Books. He holds numerous patents, is widely published in science journals, and has provided over 300 lectures and presentations to military and civilian universities, as well as foreign governments. The December 2003 issue of the Acumen Journal of Life Sciences named Dr. Alibek as one of top five biological warfare experts in the nation.

Charles Bailey, Ph.D.

Dr. Bailey is the former commander of the U.S. Army Medical Research Institute of Infectious Diseases (USAMRIID). Dr. Bailey has 25 years U.S. Army experience in R&D and management in infectious diseases and biological warfare defense. As an officer of the Defense Intelligence Agency, Dr. Bailey wrote extensively on foreign biological warfare capabilities. Dr. Bailey is currently the Executive Director for Research & International Relations at the National Center for Biodefense at George Mason University (GMU), and is a Distinguished Professor of Biology at GMU as well. The Acumen Journal of Life Sciences named Dr. Bailey as one of the top five biological warfare experts in the nation.

Members of the Scientific Advisory Board do not receive any compensation for service on the Board. From time to time, as management sees fit, we may engage them on consulting assignments for a fee on specific projects.

INVOLVEMENT IN LEGAL PROCEEDINGS.

To the best of our knowledge, during the past five years, none of the following occurred with respect to a present or former director or executive officer of the Company: (1) any bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time; (2) any conviction in a criminal proceeding or being subject to a pending criminal proceeding (excluding traffic violations and other minor offenses); (3) being subject to any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of any competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities or banking activities; and (4) being found by a court of competent jurisdiction (in a civil action), the SEC or the Commodities Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended

or vacated.

CODE OF ETHICS

Our Board of Directors is in the process of preparing a code of ethics which would apply to all of our officers, directors and employees.

ITEM 10. EXECUTIVE COMPENSATION

The following table sets forth compensation received for the fiscal years ended March 31, 2002 through 2004 by our Chief Executive Officer and all executive officers.

SUMMARY COMPENSATION TABLE

		ANNUAL COMPENSATION			LONG-TERM COMPENSATION		
					AWARDS		
NAME AND PRINCIPAL POSITION	YEAR	SALARY ($)(1)	BONUS ($)	OTHER ANNUAL COMPENSATION ($)	RESTRICTED STOCK ($)	OPTIONS SARs (#)	PAYOUTS/ LTIP PAYOUTS ($)
James A. Joyce	2004	180,000	-			-	
Chairman,	2003	180,000	-			250,000	
President/CEO	2002	180,000					
Richard H. Tullis,	2004	150,000	-			-	
Ph.D. Vice President,	2003	150,000	-			250,000	
Chief Scientific Officer	2002	150,000				30,000	
Edward C. Hall (2)	2004	28,530(2)	-			-	
Vice President, Chief	2003	25,000					
Financial Officer	2002	N/A					

(1) The remuneration described in the above table does not include our cost of benefits furnished to the named executive officers, including premiums for health insurance and other personal benefits provided to such individuals that are extended to all our employees in connection with their employment. Perquisites and other personal benefits, securities, or property received by an executive officer are either the lesser of $50,000 or 10% of the total salary and bonus reported for each named executive officer, except as otherwise disclosed.

(2) Mr. Hall became a part-time employee and was elected CFO of the Company on August 14, 2002. He is compensated on an hourly basis, a portion of which, amounting to $5,706 in fiscal 2004, is paid to Tatum CFO Partners, LLP of which he is a partner.

OPTION/SAR GRANTS IN THE LAST FISCAL YEAR

None.

AGGREGATED OPTIONS/SAR EXERCISES IN THE LAST FISCAL YEAR AND FISCAL YEAR-END OPTION/SAR VALUES

The following table sets forth the number of common stock options, both exercisable and unexercisable, held by each of our Named Executive Officers and the value of any in-the-money options at March 31, 2004, utilizing a value of $1.35 per share, the closing price of our common stock on the OTCBB on March 31, 2004:

	SHARES ACQUIRED ON EXERCISE (#)	VALUE REALIZED ($)	NUMBER OF UNEXERCISED OPTIONS AT MARCH 31, 2004 (EXERCISABLE/ UNEXERCISABLE)	VALUE OF IN-THE-MONEY OPTIONS AT MARCH 31, 2004 (EXERCISABLE/ UNEXERCISABLE)
James A. Joyce	--	$ --	250,000/--	$0.0/$0.0
Richard H. Tullis	--	$ --	280,000/--	$0.0/$0.0
Edward C. Hall	--	$ --	N/A	N/A

EMPLOYMENT AGREEMENTS

We entered into an employment agreement with Mr. Joyce effective April 1, 1999. Effective June 1, 2001, Mr. Joyce was appointed our President and Chief Executive Officer and his base annual salary was increased from $120,000 to $180,000. Under the terms of the agreement, his employment continues at a salary of $180,000 per year for successive one year periods, unless given notice of termination 60 days prior to the anniversary of his employment agreement.

We entered into an employment agreement with Dr. Tullis effective January 10, 2000. Effective June 1, 2001, Dr. Tullis was appointed our Chief Science Officer of the Company. His compensation under the agreement was modified in June 2001 from $80,000 to $150,000 per year. Under the terms of the agreement, his employment continues at a salary of $150,000 per year for successive one year periods, unless given notice of termination 60 days prior to the anniversary of his employment agreement. Dr. Tullis was granted 250,000 stock options to purchase our common stock in connection the completing certain milestones, such as the initiation and completion of certain clinical trials, the submission of proposals to the FDA and the filing of a patent application.

Both Mr. Joyce and Dr. Tullis' agreements provide for medical insurance and disability benefits, one year of severance pay if their employment is terminated by us without cause or due to change in our control before the expiration of their agreements, and allow for bonus compensation and stock option grants as determined by our Board of Directors.

Both agreements also contain restrictive covenants preventing competition with us and the use of confidential business information, except in connection with the performance of their duties for us, for a period of two years following the termination of their employment with us.

Effective August 14, 2002, Mr. Hall was elected our Vice President, Chief Financial Officer. His employment is subject to 30 days' notice, with no

severance pay provisions, in accordance with his employment agreement. He receives no medical or other benefits from us.

STOCK OPTION GRANTS

Our 2000 Stock Option Plan (the "Plan"), adopted by us in August 2000, provides for the grant of incentive stock options ("ISOs") to full-time employees (who may also be Directors) and nonstatutory stock options ("NSOs") to non-employee Directors, consultants, customers, vendors or providers of significant services. The exercise price of any ISO may not be less than the fair market value of our Common Stock on the date of grant or, in the case of an optionee who owns more than 10% of the total combined voting power of all classes of our outstanding stock, not be less than 110% of the fair market value on the date of grant. The exercise price, in the case of any NSO, must not be less than 75% of the fair market value of our Common Stock on the date of grant. The amount available under the Plan is 500,000 options.

At March 31, 2004, we had granted 47,500 options under the Plan, with 452,500 available for future issuance. We issued the remaining 1,966,415 options (of which 637,800 have been exercised or cancelled) outside of the Plan.

At March 31, 2004, we had outstanding options to purchase 1,376,115 shares of our Common Stock. See Item 11, "Security Ownership of Certain Beneficial Owners and Management."

OUTSTANDING STOCK PURCHASE WARRANTS

Common Stock purchase warrants

At March 31, 2004, we had outstanding a total of 3,907,764 warrants, exercisable at prices between $0.25 - 6.50 per share and with expiration dates from 2004 - 2007.

See Item 11, "Security Ownership of Certain Beneficial Owners and Management."

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding the beneficial ownership of our Common Stock as of August 20, 2004 for:

- each person known by us to be the beneficial owner of 5% or more of our Common Stock;

- each of our Directors and each of our executive officers whose name appears in the summary compensation table (the "Executive Officers"); and

- all of our Directors and the Executive Officers as a group.

Except as otherwise noted in the footnotes below, the entity, individual Director or Executive Officer has sole voting and investment power over such securities.

	COMMON (VOTING)

NAME AND ADDRESS OF BENEFICIAL OWNERS (1) (2)	AMOUNT	%(3)
Calvin M. Leung (5)(6)(7) P.O. Box 2366 Costa Mesa, CA 92628	2,352,643	17.1%
Rod Tompkins (6)(8) 420 Douglas Wayne, NE 68787	1,520,000	11.3%
Fusion Capital Fund II, LLC (6)(9) 222 Merchandise Mart Plaza, Suite 9-112 Chicago, IL 60654	1,604,966	9.9%
James A. Joyce (4)(5)(6)(10)	850,000	6.2%
Franklyn S. Barry, Jr. (5)(11)	418,593	3.0%
Richard H. Tullis (4)(5)(12)	330,000	2.4%
Edward G. Broenniman (5)(13)	261,374	1.9%
Edward C. Hall(4)	0	*
Directors and executive officers, as a group (6 members)	4,212,610	28.7%

---

* Less than one percent.

(1) Beneficial ownership is determined in accordance with Rule 13d-3 under the Securities Exchange Act and is generally determined by voting power and/or investment power with respect to securities. Except as indicated by footnote and subject to community property laws where applicable, we believe that the persons named in the table above have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them. Unless otherwise indicated, the address of each shareholder is 3030 Bunker Hill Street, Suite 4000, San Diego, CA 92109.

(2) A person is deemed to be the beneficial owners of securities that can be acquired by such person within 60 days from August 20, 2004 upon the exercise of warrants or options. Each beneficial owner's percentage ownership is determined by assuming that options and warrants that are held by such person (but not those held by any other person) and that are exercisable within 60 days from August 20, 2004.

(3) Assumes 13,453,550 shares of Common Stock outstanding at August 20, 2004.

(4) Executive officer.

(5) Director.

(6) More-than-5% shareholder.

(7) Includes all shares owned by members of Mr. Leung's family and entities he controls plus 10,000 warrants at $3.00, expiring on January 1, 2006 and 306,000 warrants at $0.25, expiring on July 11, 2004 and January 29, 2005.

(8) Includes 20,000 warrants to purchase common stock at $0.25 per share, expiring on April 2, 2005.

(9) Includes 568,181 warrants to purchase common stock at $0.76 per share, expiring on the third anniversary of the date of an effective registration statement, the initial filing of which is expected to be on June 29, 2004. Pursuant to the terms of the warrant, Fusion Capital is not entitled to exercise the warrants to the extent such exercise would cause the aggregate number of shares of common stock beneficially owned by the Fusion Capital to exceed 9.9% of the outstanding shares of the common stock following such exercise.

(10) Includes 250,000 stock options exercisable at $1.90 per share.

(11) Includes options to purchase 412,500 shares at $3.00.

(12) Includes 250,000 stock options exercisable at $1.90 per share and 30,000 stock options exercisable at $2.56 per share. (13) Includes 53,885 shares owned by Mr. Broenniman's wife and his options to purchase 3,000 shares at $1.78 and 2,500 shares at $3.75.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Franklyn S. Barry, Jr., a director and shareholder of Aethlon Medical, was engaged as a consultant to the Company on strategic and business issues from June 1, 2001 to May 31, 2003 and was paid $60,000 per year. Mr. Barry had been our original President and Chief Executive Officer and served in such capacities until 2001. See Item 9, "Directors and Executive Officers" and Item 11, "Security Ownership of Certain Beneficial Owners and Management."

Calvin M. Leung, a director and shareholder of Aethlon Medical, was previously engaged as our consultant and he and his affiliates have invested approximately $939,500 in Aethlon Medical to date, through equity and convertible debt securities. $448,000 was invested via convertible promissory notes from November 2001 through May 2002. The notes accrued interest at rates ranging from 6.75% to 12% per annum. Mr. Leung invested $300,000 via the exercise of stock options received while our consultant for which he received 600,000 shares of restricted common stock. Mr. Leung and his affiliates also invested during 2003 a total of $146,500 in cash for 586,000 shares of our restricted common stock. Finally, Mr. Leung and his affiliates invested approximately $45,000 from September 2003 to February 2004 via the exercise of warrants that resulted in the issuance of 180,000 shares of our restricted common stock. Mr. Leung worked as our consultant from January 7, 2001 to January 7, 2003. We do not expect Mr. Leung to provide consulting services now that he is a member of our board of directors. He currently owns 2,036,643 of our common shares and 316,000 warrants to purchase common stock at prices between $0.25 to $3.00 per share. (See ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT)

Certain of our officers and other related parties have advanced us funds, agreed to defer compensation or paid expenses on behalf of us to cover

short-term working capital deficiencies in the aggregate amount of approximately $1.7 million. These non interest-bearing liabilities have been included as due to related parties in the accompanying financial statements.

Effective January 1, 2000, we entered into an agreement with Dr. Julian Ambrus, the son of Dr. Clara Ambrus, who was the original founder of Hemex, Inc. Under this agreement, an invention and related patent rights for a method of removing HIV and other viruses from the blood using the Hemopurifier(TM) were assigned to us by the inventors in exchange for (a) a royalty to be paid on future sales of the patented product or process equal to 8.75% of net sales, as defined and (b) 12,500 shares of our restricted common stock. Upon the issuance of the first United States patent relating to the invention, we were obligated to issue an additional 12,500 shares of our restricted common stock to the inventors. If the market price of our common stock on the date the patent was issued was below $8 per share, the number of shares to be issued was that amount which equates to $100,000 of market value. On March 4, 2003, the related patent was issued and, as a result, we issued 196,078 shares of our restricted common stock valued at $100,000 which is included in professional fees in the accompanying consolidated statements of operations.

We believe that each of the related party transactions discussed above is on terms as favorable as could have been obtained from unaffiliated third parties.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

The following documents are filed as part of this report on Form 10-KSB:

1. Consolidated Financial Statements for the periods ended March 31, 2004 and 2003:

Independent Auditors' Reports
Consolidated Balance Sheet
Consolidated Statements of Operations
Consolidated Statements of Cash Flows
Consolidated Statements of Stockholders' Deficit
Notes to Consolidated Financial Statements

2. Exhibits

The following exhibits are being filed with this Annual Report on Form 10-KSB and/or are incorporated by reference therein in accordance with the designated footnote references:

3.1	Our Articles of Incorporation and Bylaws (1)
3.2	Certificate of Amendment of Articles of Incorporation dated March 28, 2000 (2)
10.1	Employment Agreement between us and Franklyn S. Barry, Jr. dated April 1, 1999 (3)
10.2	Employment Agreement between us and James A. Joyce dated April 1, 1999 (3)
10.3	Agreement and Plan of Reorganization Between Aethlon Medical and Aethlon, Inc. dated March 10, 1999 (4)

10.4 Agreement and Plan of Reorganization Between us and Hemex, Inc. dated March 10, 1999 (4)

10.5 Agreement and Plan of Reorganization Between us and Syngen Research, Inc. (5)

10.6 Agreement and Plan of Reorganization Between us and Cell Activation, Inc. (6)

10.7 Common Stock Purchase Agreement between Aethlon Medical and Fusion Capital Fund II, LLC. (7)

10.8 Registration Rights Agreement between Aethlon Medical and Fusion Capital Fund II, LLC. (7)

10.9 Form of Securities Purchase Agreement for Private Placement closing on June 7, 2004 (7)

10.10 Form of Common Stock Purchase Warrant for Private Placement closing on June 7, 2004 (7)

10.11 Form of Registration Rights Agreement for Private Placement closing on June 7, 2004 (7)

10.12 2003 Consultant Stock Plan (8)

10.13 Lease by and between Aethlon Medical and San Diego Science Center*

10.14 Consulting Agreement by and between Aethlon Medical and Jean-Claude Chermann, PhD.*

10.15 Consulting Agreement by and between Aethlon Medical, Inc. and Franklyn S. Barry, Jr.*

10.16 Patent License Agreement by and amongst Aethlon Medical, Inc., Hemex, Inc., Dr. Julian L. Ambrus and Dr. David O. Scamurra*

10.17 Employment Agreement by and between Aethlon Medical, Inc. and Dr. Richard H. Tullis*

10.18 Employment Agreement by and between Aethlon Medical, Inc. and Mr. Edward C. Hall*

23.1 Consent of Independent Auditors

31.1 Certification of our Chief Executive Officer and President, pursuant to Securities Exchange Act rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

31.2 Certification of our Chief Financial Officer, pursuant to Securities Exchange Act rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

32.1 Statement of our Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)

32.2 Statement of our Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)

In accordance with Item 601(b)(32)(ii) of Regulation S-B and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibit 32.1 hereto are deemed to accompany this Form 10-KSB and will not be deemed "filed" for purpose of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Registrant specifically incorporates it by reference

(1) Filed with our Registration Statement on Form SB-2 dated December 18, 2000 and incorporated by reference.

(2) Filed with our Annual Report on Form 10-KSB for the year ended March 31, 2000 and incorporated by reference.

(3) Filed with our Annual Report on Form 10-KSB for the year ended March 31, 1999 and incorporated by reference.

(4) Filed with our Current Report on Form 8-K dated March 10, 1999 and incorporated by reference.

(5) Filed with our Current Report on Form 8-K dated January 10, 2000 and incorporated by reference.

(6) Filed with our Current Report on Form 8-K dated April 10, 2000 and incorporated by reference.

(7) Filed with our Current Report on Form 8-K dated June 7, 2004 and incorporated by reference.

(8) Incorporated by reference from our Registration Statement on Form S-8 (File No. 333-114017) filed on March 29, 2004.

(b) Reports on Form 8-K.

Current Report on Form 8-K dated June 7, 2004 (filed with the SEC on June 7, 2004) relating to our private placement and common stock purchase agreement with Fusion Capital Fund II, LLC

* Filed herewith

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table presents fees for professional services rendered by Squar, Milner, Reehl & Williamson LLP ("Squar Milner") for the annual audit of our consolidated financial statements as of and for the fiscal years ended March 31, 2004, and 2003 and fees billed for other services rendered by Squar Milner during such years:

	Fiscal Years Ended March 31,	
	2004	2003
Audit Fees	$55,500	$60,000

Audit Related Fees	2,500 (1)	-
Tax Fees	-	-
All Other Fees	-	-
	$58,000	$60,000

(1) Such amount represents services rendered in connection with Form S-8.

POLICY ON AUDIT COMMITTEE PRE-APPROVAL OF AUDIT AND PERMISSIBLE NON-AUDIT SERVICES OF INDEPENDENT AUDITOR

Our audit committee of the Board of Directors is responsible for pre-approving all audit and permitted non-audit services to be performed for us by our independent auditor.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 8th day of September 2004.

BY: /S/ JAMES A. JOYCE
JAMES A. JOYCE
CHAIRMAN, PRESIDENT & CHIEF EXECUTIVE OFFICER

BY: /S/ EDWARD C. HALL
EDWARD C. HALL
VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/S/ JAMES A. JOYCE JAMES A. JOYCE	CHAIRMAN OF THE BOARD	SEPTEMBER 8, 2004
/S/ FRANKLYN S. BARRY, JR. FRANKLYN S. BARRY, JR.	DIRECTOR	SEPTEMBER 8, 2004
/S/ EDWARD G. BROENNIMAN EDWARD G. BROENNIMAN	DIRECTOR	SEPTEMBER 8, 2004
/S/ RICHARD H. TULLIS	DIRECTOR	SEPTEMBER 8, 2004

RICHARD H. TULLIS

/S/ CALVIN M. LEUNG	DIRECTOR	SEPTEMBER 8, 2004

CALVIN M. LEUNG

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)

CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2004

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Aethlon Medical, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheet of Aethlon Medical, Inc. and Subsidiaries (the "Company"), a development stage company, as of March 31, 2004 and the related consolidated statements of operations, stockholders' deficit and cash flows for each of the years in the two-year period then ended and for the period from January 31, 1984 (Inception) to March 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Aethlon Medical,

Inc. and Subsidiaries as of March 31, 2004 and the results of their operations and their cash flows for the each of the years in the two-year period then ended and for the period from January 31, 1984 (Inception) to March 31, 2004, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. At March 31, 2004, the Company has negative working capital of approximately $3,930,000 and a deficit accumulated during the development stage of approximately $17,045,000. As discussed in Note 1 to the consolidated financial statements, a significant amount of additional capital will be necessary to advance the development of the Company's products to the point at which they may become commercially viable. These conditions, among others, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans regarding these matters are also described in Note 1. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As more fully described in Note 12, management has recently determined that $100,000 assigned to certain common stock issued in March 2003 related to the acquisition of a patent was inadvertently expensed. Accordingly, the March 31, 2003 consolidated balance sheet has been restated to report such amount as a charge to additional paid-in capital. In addition, the accompanying consolidated statement of operations for the year then ended has been restated to reduce the fiscal 2003 net loss by $100,000 ($0.01 per common share).

/S/ SQUAR, MILNER, REEHL & WILLIAMSON, LLP
MAY 18, 2004 (except for the fifth paragraph
of this report and the last paragraph of Note 12,
as to which the date is August 31, 2004)

NEWPORT BEACH, CALIFORNIA

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONSOLIDATED BALANCE SHEET (AS RESTATED)
March 31, 2004

ASSETS	
CURRENT ASSETS	
Cash	$ 1,619
Prepaid expenses	5,582
TOTAL CURRENT ASSETS	7,201
Property and equipment, net	16,741
Patents, net	237,314
Other assets	20,405
TOTAL NONCURRENT ASSETS	274,460

TOTAL ASSETS	$ 281,661

LIABILITIES AND STOCKHOLDERS' DEFICIT

CURRENT LIABILITIES	
Accounts payable and accrued liabilities	$ 1,588,381
Due to related parties	1,673,457
Notes payable	500,000
Convertible notes payable	175,000
TOTAL CURRENT LIABILITIES	3,936,838
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' DEFICIT	
Common stock, par value of $0.001, 25,000,000 shares authorized; 10,649,329 issued and outstanding	10,649
Additional paid in capital (as restated)	13,379,487
Deficit accumulated during the development stage (as restated)	(17,045,313)
TOTAL STOCKHOLDERS' DEFICIT	(3,655,177)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 281,661

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF OPERATIONS (As Restated)
For the Years Ended March 31, 2004 and 2003 and
For the Period January 31,1984 (Inception) Through March 31, 2004

	2004	2003	January 31, 1984 (Inception) Through March 31, 2004
Grant income	$ --	$ --	$ 1,424,012
Subcontract income	--	--	73,746
Sale of research and development	--	--	35,810
	--	--	1,533,568
OPERATING EXPENSES			
Professional fees	339,787	660,949	3,666,626
Payroll and related	417,486	549,611	5,570,510

General and administrative	238,276	326,521	3,482,441
Impairment of intangible assets	--	334,304	1,231,531
	995,549	1,871,385	13,951,108
OPERATING LOSS	(995,549)	(1,871,385)	(12,417,540)
OTHER (INCOME) EXPENSE			
Interest expense	523,249	489,731	4,507,581
Interest income	--	--	(17,415)
Other	--	--	137,607
	523,249	489,731	4,627,773
NET LOSS	$ (1,518,798)	$ (2,361,116)	$(17,045,313)
Basic and diluted loss per common share	$ (0.19)	$ (0.43)	
Weighted average number of common shares outstanding	8,181,612	5,553,196	

SEE ACCOMANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(As Restated) For the Years Ended March 31, 2004 and 2003 and
For the Period January 31, 1984 (Inception) Through March 31, 2004

	COMMON STOCK		ADDITIONAL PAID IN	DEFICIT ACCUMULATED DURING DEVELOPMENT
	SHARES	AMOUNT	CAPITAL	STAGE
Balance, January 31, 1984 (Inception)	--	$ --	$ --	$ --
Common stock issued for cash at $1 per share	22,000	22	26,502	--
Common stock issued for cash at $23 per share	1,100	1	24,999	--
Common stock issued for cash at $86 per share	700	1	59,999	--
Common stock issued for cash at $94 per share	160	1	14,999	--

Common stock issued for cash at $74 per share	540	1	39,999	--
Common stock issued for cash at $250 per share	4,678	5	1,169,495	--
Capital contributions	--	--	521,439	--
Common stock issued for compensation at $103 per share	2,600	3	267,403	--
Conversion of due to related parties to common stock at $101 per share	1,120	1	113,574	--
Conversion of due to related parties to common stock at $250 per share	1,741	2	435,092	--
Effect of reorganization	2,560,361	2,558	(2,558)	--
Common stock issued in connection with employment contract at $8 per share	65,000	65	519,935	--
Common stock issued in connection with the acquisition of patents at $8 per share	12,500	13	99,987	--
Warrants issued to note holders in connection with notes payable	--	--	734,826	--
Warrantes issued for services	--	--	5,000	--
Net loss	--	--	--	(4,746,416
BALANCE, MARCH 31, 2000	2,672,500	2,673	4,030,691	(4,746,416
Common stock and options issued in connection with acquisition of Cell Activation, Inc. at $7.20 per share	99,152	99	1,067,768	--
Warrants issued to note holders in connection with notes payable	--	--	218,779	--
Warrants issued to promoter in connection with notes payable	--	--	298,319	--
Beneficial conversion feature of convertible notes payable	--	--	150,000	--
Warrants issued to promoter in connection with convertible notes payable	--	--	299,106	--
Options issued to directors for services as board members	--	--	14,163	--
Options and warrants issued for services	--	--	505,400	--

Common stock issued for services at $3 per share	5,500	5	16,495	--
Common stock issued for cash at $1 per share	100,000	100	99,900	--
Net loss	--	--	--	(4,423,073
BALANCE, MARCH 31, 2001	2,877,152	$ 2,877	$ 6,700,621	$ (9,169,489

(continued)

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(As Restated) For the Years Ended March 31, 2004 and 2003 and
For the Period January 31, 1984 (Inception) Through March 31, 2004 (continued)

	COMMON STOCK		ADDITIONAL PAID IN	DEFICIT ACCUMULATED DURING DEVELOPMENT
	SHARES	AMOUNT	CAPITAL	STAGE
BALANCE, MARCH 31, 2001	2,877,152	$ 2,877	$ 6,700,621	$ (9,169,489
Common stock, warrants and options issued for accounts payable and accrued liabilities	21,750	22	243,353	--
Common stock issued for services at $2.65 per share	6,038	6	15,994	--
Common stock issued for cash at $1.00 per share, net of issuance costs of $41,540 paid to a related party	730,804	731	688,533	--
Common stock issued for services at $2.75 per share	10,000	10	27,490	--
Common stock issued in connection with license agreement at $3.00 per share	6,000	6	17,994	--
Common stock issued to holder of convertible notes payable at $3.00 per share	70,586	71	211,687	--
Options issued to directors for services as board members	--	--	7,459	--
Common stock issued for cash at				

$1.50 per share, net of issuance costs of $2,500	16,667	17	22,483	--
Beneficial conversion feature of convertible notes payable	--	--	185,000	--
Common stock issued for conversion of convertible notes payable and accrued interest at an average price of $1.24 per share	134,165	134	166,352	--
Common stock issued for services at $2.72 per share	9,651	10	26,240	--
Options issued to consultant for services	--	--	562,000	--
Common stock and warrants for services at $1.95 per share	62,327	62	161,475	--
Common stock issued for services at $1.90 per share	9,198	9	17,491	--
Stock options exercised for cash	400,000	400	199,600	--
Warrants issued to note holders for 90-day forebearance	--	--	118,000	--
Common stock and warrants issued to note holders and vendors in the debt-to-equity conversion program at $1.25 per share	816,359	816	1,623,635	--
Other warrant transactions	--	--	(32,715)	--
Net loss	--	--	--	(3,995,910
BALANCE - MARCH 31, 2002	5,170,697	$ 5,171	$ 10,962,692	$(13,165,399

(continued)

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(As Restated) For the Years Ended March 31, 2004 and 2003 and
For the Period January 31, 1984 (Inception) Through March 31, 2004 (continued)

	COMMON STOCK		ADDITIONAL PAID IN	DEFICIT ACCUMULATED DURING DEVELOPMENT
	SHARES	AMOUNT	CAPITAL	STAGE

BALANCE - MARCH 31, 2002	5,170,697	$ 5,171	$ 10,962,692	$(13,165,399
Proceeds from the issuance of common stock at $0.50 per share in connection with the exercise of options	200,000	200	99,800	--
Interest expense related to beneficial conversion feature	--	--	150,000	--
Pro-rata fair value assigned to warrants issued in connection with conversion of accounts payable	--	--	71,000	--
Pro-rata fair value assigned to warrants issued in connection with note payable	--	--	30,000	--
Issuance of common stock at $1.25 per share in connection with the conversion of accounts payable	150,124	150	187,505	--
Issuance of common stock at $1.25 per share in connection with the conversion of notes payable	420,000	420	104,580	--
Estimated fair value of options issued for service	--	--	114,000	--
Issuance of common stock at $0.25 per share for cash	461,600	462	114,938	--
Issuance of common stock at $0.26 per share for cash	19,230	19	4,981	--
Issuance of common stock at $1.25 per share for cash	8,000	8	9,992	--
Issuance of common stock at $0.65 per share for services	69,231	69	44,931	--
Issuance of common stock at $0.51 per share for services	196,078	196	(196)	--
Net loss (As Restated)	--	--	--	(2,361,116
BALANCE - MARCH 31, 2003 (As Restated)	6,694,960	$ 6,695	$ 11,894,223	$(15,526,515

(continued)

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(As Restated) For the Years Ended March 31, 2004 and 2003 and
For the Period January 31, 1984 (Inception) Through March 31, 2004 (continued)

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

Issuance of common stock at $0.40 per share for services	62,000	62	24,763	--
Issuance of common stock at $0.45 per share for services	185,185	185	83,148	--
Issuance of common stock at $0.50 per share for services	5,000	5	2,495	--
Interest expense related to beneficial conversion feature	--	--	324,800	--
Net loss (As Restated)	--	--	--	(1,518,798
BALANCE - MARCH 31, 2004 (As Restated)	10,649,329	$ 10,649	$ 13,379,487	$(17,045,313

(continued)

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS (As Restated) For the Years Ended March 31, 2004 and 2003 and For the Period January 31, 1984 (Inception) Through March 31, 2004

	2004	2003
Cash flows from operating activities:		
Net loss	$ (1,518,798)	$ (2,361,116)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	127,000	159,783
Gain of sale of property and equipment	--	--
Estimated fair value of warrants issued in connection with accounts payable and debt	--	101,000
Estimated fair value of common stock, warrants and options issued for services	138,158	159,000
Beneficial conversion feature of convertible notes payable	324,800	150,000
Impairment of patents and patents pending	--	334,304
Impairment of goodwill	--	--
Deferred compensation forgiven	--	--
Changes in operating assets and liabilities:		
Prepaid expenses	4,728	130,478
Other assets	(14,800)	(3,650)
Accounts payable and accrued liabilities	138,398	474,054
Due to related parties	258,458	341,644
Net cash used in operating activities	(542,056)	(514,503)

Cash flows from investing activities:		
Purchases of property and equipment	(4,782)	(1,198)
Patents and patents pending	--	(49,034)
Proceeds from the sale of property and equipment	--	--
Cash of acquired company	--	--
Net cash used in investing activities	(4,782)	(50,232)
Cash flows from financing activities:		
Proceeds from the issuance of notes payable	--	65,000
Principal repayments of notes payable	(180,000)	(10,000)
Proceeds from the issuance of convertible notes payable	200,000	275,000
Proceeds from the issuance of common stock	522,125	230,400
Net cash provided by financing activities	542,125	560,400
Net (decrease) increase in cash	(4,713)	(4,335)
Cash at beginning of period	6,332	10,667
Cash at end of period	$ 1,619	$ 6,332
Supplemental disclosure of cash flow information -		
Cash paid during the period for:		
Interest	$ 13,000	$ 13,000
Income taxes	$ 1,180	$ 1,180
Supplement schedule of noncash investing activities:		
Debt converted to common stock	$ 407,500	$ 205,000
Issuance of common stock, warrants and options for accounts payable	$ --	$ 87,655
Issuance of common stock in connection with license agreements	$ --	$ --
Net assets of entities acquired in exchange for equity securities	$ --	$ --
Debt placement fees paid by issuance of warrants	$ --	$ --
Patent pending acquired for 12,500 shares of common stock	$ --	$ --
Common stock issued for prepaid expenses	$ --	$ --

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2004

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Aethlon Medical, Inc. ("Aethlon") engages in the research and development of a medical device known as the Hemopurifier(TM) that removes harmful substances from the blood. Aethlon is in the development stage on the Hemopurifier(TM) and significant research and testing are still needed to reach commercial viability. Any resulting medical device or process will require approval by the U.S. Food and Drug Administration ("FDA"), and Aethlon has not yet begun efforts to obtain any FDA approval, which may take several years. Since many of Aethlon's patents were issued in the 1980's, they are scheduled to expire in the near future. Thus, such patents may expire before FDA approval, if any, is obtained. However, the Company believes that certain patent applications and/or other patents issued more recently will help protect the proprietary nature of the Hemopurifier(TM) treatment technology.

Aethlon is classified as a development stage enterprise under accounting principles generally accepted in the United States of America ("GAAP"), and has not generated revenues from its planned principal operations.

Aethlon's common stock is quoted on the Over-the-Counter Bulletin Board administered by the National Association of Securities Dealers ("OTCBB") under the symbol "AEMD."

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Aethlon Medical, Inc. and its inactive legal wholly-owned subsidiaries Aethlon, Inc., Hemex, Inc., Syngen Research, Inc. and Cell Activation, Inc. (hereinafter collectively referred to as the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

GOING CONCERN

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates, among other things, the realization of assets and satisfaction of liabilities in the ordinary course of business. The Company has negative working capital of approximately $3,930,000 and a deficit accumulated during the development stage of approximately $17,045,000 at March 31, 2004, which among other matters, raise substantial doubt about its ability to continue as a going concern. A significant amount of additional capital will be necessary to advance the development of the Company's products to the point at which they may become commercially viable. The Company intends to fund operations through debt and/or equity financing arrangements, which management believes may be insufficient to fund its capital expenditures, working capital and other cash requirements (consisting of accounts payable, accrued liabilities, amounts due to related parties and amounts due under various notes payable) for the fiscal year ending March 31, 2005. Therefore, the Company will be required to seek additional funds to finance its long-term operations.

The Company is currently addressing its liquidity issue by continually seeking investment capital through the public markets, specifically, through private placement of common stock and a common stock purchase agreement with an investor which has committed to buy up to an additional $6,000,000 of the Company's common stock over a 30-month period, commencing, at the Company's election, if and after the Securities Exchange Commission (the "SEC") declares effective a registration statement covering such shares. However, no assurance can be given

that the Company will receive any additional funds under such agreement and there is no guarantee that these strategies will enable the Company to meet its obligations for the foreseeable future. The successful outcome of future activities cannot be determined at this time and there is no assurance that if achieved, the Company will have sufficient funds to execute its intended business plan or generate positive operating results.

The consolidated financial statements do not include any adjustments related to recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2004

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

RISKS AND UNCERTAINTIES

The Company operates in an industry that is subject to intense competition, government regulation and rapid technological change. The Company's operations are subject to significant risk and uncertainties including financial, operational, technological, regulatory and other risks associated with a development stage company, including the potential risk of business failure.

USE OF ESTIMATES

The Company prepares its consolidated financial statements in conformity with GAAP, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, among others, realization of long-lived assets. Actual results could differ from those estimates.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards ("SFAS") No. 107, "DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS," requires disclosure of fair value information about financial instruments when it is practicable to estimate that value. The carrying amount of the Company's cash, accounts payable, accrued liabilities and notes payable approximates their estimated fair values due to the short-term maturities of those financial instruments. The fair values of amounts due to related parties are not determinable as these transactions are with related parties and were not necessarily consummated at arm's length. .

CONCENTRATIONS OF CREDIT RISKS

Cash is maintained at various financial institutions. The Federal Deposit Insurance Corporation ("FDIC") insures accounts at each institution for up to $100,000. At times, cash may be in excess of the FDIC insurance limit. The Company had no amounts exceeding this limit at March 31, 2004.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is computed using the

straight-line method over the estimated useful lives of the related assets, which range from two to five years. Repairs and maintenance are charged to expense as incurred while improvements are capitalized. Upon the sale or retirement of property and equipment, the accounts are relieved of the cost and the related accumulated depreciation with any gain or loss included in the statements of operations. At March 31, 2004, property and equipment consisted exclusively of furniture and equipment with a total cost approximating $209,000 and accumulated depreciation approximating $192,000. Depreciation expense approximated $8,000 and $18,000 for the years ended March 31, 2004 and 2003, respectively.

INCOME TAXES

Under SFAS 109, "ACCOUNTING FOR INCOME TAXES," deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statements and their respective tax basis. Deferred income taxes reflect the net tax effects of (a) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts reported for income tax purposes, and (b) tax credit carryforwards. The Company records a valuation allowance for deferred tax assets when, based on management's best estimate of taxable income in the foreseeable future, it is more likely than not that some portion of the deferred income tax assets may not be realized.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

LONG-LIVED ASSETS

SFAS 144, "ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF," addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If the cost basis of a long-lived asset is greater than the projected future undiscounted net cash flows from such asset, an impairment loss is recognized.

Impairment losses are calculated as the difference between the cost basis of an asset and its estimated fair value. SFAS 144 also requires companies to separately report discontinued operations and extends that reporting requirement to a component of an entity that either has been disposed of (by sale, abandonment or in a distribution to owners) or is classified as held for sale. Assets to be disposed of are reported at the lower of the carrying amount or the estimated fair value less costs to sell. The Company adopted SFAS 144 on January 1, 2002. The provisions of this pronouncement relating to assets held for disposal generally are required to be applied prospectively after the adoption date to newly initiated commitments to sell or dispose of such assets, (as defined), by management. As a result, management cannot determine the potential effects that adoption of SFAS 144 will have on the Company's financial statements with respect to future disposal decisions, if any. Management believes no impairment exists at March 31, 2004.

EARNINGS PER SHARE

Under SFAS 128, "EARNINGS PER SHARE," basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares assumed to be outstanding during the period of computation. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive (If the Company had net income in each of the years ended March 31, 2004 and 2003, approximately 2,500,000 and 2,900,000 shares would have been considered additional common stock equivalents, respectively, based on the treasury stock method). As the Company had net losses for the period presented, basic and diluted loss per share are the same, as any additional common stock equivalents would be antidilutive.

SEGMENTS

SFAS 131, "DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION," changes the way public companies report information about segments of their business in their annual financial statements and requires them to report selected segment information in their quarterly reports issued to shareholders. It also requires entity-wide disclosures about the products and services an entity provides, the foreign countries in which it holds significant assets and how the Company reports revenues and its major customers. The Company currently operates in one segment, as disclosed in the accompanying consolidated statements of operations.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STOCK BASED COMPENSATION

The Company accounts for stock-based compensation issued to employees using the intrinsic value based method as prescribed by Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock issued to Employees." Under the intrinsic value based method, compensation expense is the excess, if any, of the estimated fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

SFAS 123, "Accounting for Stock-Based Compensation," if fully adopted, changes the method of accounting for employee stock-based compensation plans to the fair value based method. For stock options and warrants, fair value is estimated using an option pricing model that takes into account the stock price at the measurement date, the exercise price, the expected life of the option or warrant, stock volatility and the annual rate of quarterly dividends. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

The adoption of the accounting methodology of SFAS 123 is optional and the Company has elected to continue accounting for stock-based compensation issued to employees using APB 25; however, pro forma disclosures, as if the Company had adopted the cost recognition requirement under SFAS 123, are required to be presented (see below). For stock-based compensation issued to non-employees, the

Company uses the fair value method of accounting under the provisions of SFAS 123.

Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB 25" clarifies the application of APB 25 for (a) the definition of employee for purpose of applying APB 25, (b) the criteria for determining whether a plan qualifies as a non compensatory plan, (c) the accounting consequence for various modifications to the terms of a previously fixed stock option or award and (d) the accounting for an exchange of stock compensation awards in a business combination. Management believes that the Company accounts for transactions involving stock-based employee compensation in accordance with FIN 44.

SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123," provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

At March 31, 2004, the Company has one stock-based employee compensation plan (the "Plan"), which is described more fully in Note 7. The Company accounts for the Plan under the recognition and measurement principles of APB 25, and related interpretation. No stock-based employee compensation cost is recognized in net loss. Stock options granted under the Plan have exercise prices equal to or greater than the estimated fair value of the underlying common stock on the dates of grant. The following table illustrates the effect on net loss and loss per common share (as restated for fiscal 2003 - see Note 12) if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STOCK BASED COMPENSATION (continued)

	YEAR ENDED MARCH 31,	
	2004	2003
Net loss available to common stockholders, as reported	$ 1,518,798	$ 2,361,116
Pro forma compensation expense	6,000	9,000
Pro forma net loss available to common stockholders	$ 1,524,798	$ 2,370,116
Loss per common share, as reported		
Basic and diluted	$ (0.19)	$ (0.43)

Loss per common share, pro forma		
Basic and diluted	$ (0.19)	$ (0.45)

SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 146, "Accounting for Costs Associated with Exit and Disposal Activities," was issued in June 2002 and is effective for exit and disposal activities initiated after December 31, 2002. The Company is complying with SFAS No. 146.

SFAS No. 147 relates exclusively to certain financial institutions, and thus does not apply to the Company.

In November 2002, the FASB issued FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the estimated fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of FIN No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, while the disclosure requirements became applicable in 2002. The Company is complying with the disclosure requirements of FIN No. 45. The other requirements of this pronouncement did not materially affect the Company's consolidated financial statements.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB 51." The primary objectives of FIN No. 46 are to provide guidance on the identification of entities for which control is achieved through means other than voting rights (variable interest entities or "VIEs") and how to determine when and which business enterprise should consolidate the VIE. This new model for consolidation applies to an entity for which either: (1) the equity investors do not have a controlling financial interest; or (2) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN No. 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. As amended in December 2003, the effective dates of FIN No. 46 for public entities that are small business issuers, as defined ("SBIs"), are as follows: (a) For interests in special-purpose entities ("SPEs": periods ended after December 15, 2003; and (b) For all other VIEs: periods ending after December 15, 2004. The December 2003 amendment of FIN No. 46 also includes transition provisions that govern how an SBI which previously adopted the pronouncement (as it was originally issued) must account for consolidated VIEs. The Company has determined that it does not have any variable interest in any SPEs, and is presently evaluating the other effects of FIN No. 46 (as amended) on its consolidated financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

SIGNIFICANT RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)

In April 2003, the FASB issued SFAS No. 149, "Amendments of Statement 133 on Derivative Instruments and Hedging Activities," which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. This pronouncement is effective for contracts entered into or modified after June 30, 2003 (with certain exceptions), and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity, and is effective for public companies as follows: (i) in November 2003, the FASB issued FASB Staff Position ("FSP") FAS 150-03 ("FSP 150-3"), which defers indefinitely (a) the measurement and classification guidance of SFAS No. 150 for all mandatorily redeemable non-controlling interests in (and issued by) limited-life consolidated subsidiaries, and (b) SFAS No. 150's measurement guidance for other types of mandatorily redeemable non-controlling interests, provided they were created before November 5, 2003; (ii) for financial instruments entered into or modified after May 31, 2003 that are outside the scope of FSP 150-3; and (iii) otherwise, at the beginning of the first interim period beginning after June 15, 2003. The Company adopted SFAS No. 150 on the aforementioned effective dates. The adoption of this pronouncement did not have a material impact on the Company's results of operations or financial condition.

Other recent accounting pronouncements are discussed elsewhere in these notes to the consolidated financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the American Institute of Certified Public Accountants, and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

PATENTS

The Company capitalizes the cost of patents and patents pending, some of which were acquired, and amortizes such costs over the shorter of the remaining legal life or their estimated economic life, upon issuance of the patent. STOCK

PURCHASE WARRANTS ISSUED WITH NOTES PAYABLE

The Company granted warrants in connection with the issuance of certain notes payable (see Notes 45and 6). Under Accounting Principles Board Opinion No. 14, "ACCOUNTING FOR CONVERTIBLE DEBT AND DEBT ISSUED WITH STOCK PURCHASE WARRANTS," the estimated fair value of such warrants represents a discount from the face amount of the notes payable. Accordingly, the relative estimated fair value of the warrants has been recorded in the financial statements as a discount from the face amount of the notes. The discount is amortized using the effective yield method over the respective lives of the related notes payable.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

BENEFICIAL CONVERSION FEATURE OF CONVERTIBLE NOTES PAYABLE

The convertible feature of certain notes payable (see Notes 5 and 6) provides for a rate of conversion that is below market value. Such feature is normally characterized as a "beneficial conversion feature" ("BCF"). Pursuant to Emerging Issues Task Force Issue No. 98-5 ("EITF Issue No. 98-5"), "ACCOUNTING FOR CONVERTIBLE SECURITIES WITH BENEFICIAL CONVERSION FEATURES OR CONTINGENTLY ADJUSTABLE CONVERSION RATIO" and Emerging Issues Task Force Issue No. 00-27, "APPLICATION OF EITF ISSUE NO. 98-5 TO CERTAIN CONVERTIBLE INSTRUMENTS," the Company has determined the fair value of such BCF to be approximately $325,000 and $450,000 for the years ended March 31, 2004 and 2003, respectively. Accordingly, the relative estimated fair value of the BCF has been recorded in the consolidated financial statements as a discount from the face amount of the notes. Such discounts were amortized to interest expense in accordance with the related conversion feature.

RESEARCH AND DEVELOPMENT EXPENSES

The Company incurred approximately $200,000 of research and development expenses during each of the two years ended March 31, 2004 and 2003, which are included in operating expenses in the accompanying consolidated statements of operations.

RECLASSIFICATIONS

Certain reclassifications have been made to the 2003 financial statement presentation to correspond to the 2004 format.

2. OTHER ASSETS

Other assets consist of approximately $2,000 of deposits and approximately $18,000 of advances to employees.

3. EMPLOYMENT CONTRACT

On January 10, 2000, the Company completed the acquisition of the assets of Syngen Research, Inc. ("Syngen"). As part of the transaction, the Company executed a two-year employment contract, which was subsequently amended to increase the term to four years, with Syngen's sole shareholder to perform research. The cost associated with this employment contract was amortized over four years on a straight-line basis and was fully amortized as of March 31, 2004.

4. DEBT-TO-EQUITY CONVERSION PROGRAM

In March 2002, the Company extended an offer to certain note holders and vendors to convert past due amounts into restricted common stock and warrants to purchase common stock of the Company. The offer entails the conversion of liabilities at a rate of one share and one-half of a warrant for every $1.25 converted. The warrants have an exercise price of $2.00 per share and expire three years from the date of issuance.

During the year ended March 31, 2003 and 2002, note holders and vendors representing liabilities of approximately $188,000 and $1,020,000 converted their debt in exchange for 150,124 and 816,359 shares of common stock and 75,061 and 408,180 warrants to purchase common stock, respectively. Such warrants were valued using the Black-Scholes option pricing model based on their estimated pro rata fair value of approximately $71,000 and $339,000. The warrant conversion rate was below estimated fair value for warrants issued during the fiscal year ended March 31, 2002; therefore a BCF approximating $265,000 was recorded during the year ended March 31, 2002.

AETHLON MEDICAL, INC. AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2004

5. NOTES PAYABLE

12% AND 15% NOTES

The Company entered into arrangements for the issuance of notes payable from private placement offerings (the "12% Notes"). The 12% Notes bear interest at 12% per annum, interest payable quarterly, mature one year from the date of issuance, and carry detachable warrants. At March 31, 2003, all outstanding 12% Notes had matured, and interest on such notes for periods after maturity is accruing at the annual rate of 15%. The total amount of the original notes issued was $422,500. As of March 31, 2004, all of such notes had been converted to common stock and there was no balance outstanding on the 12% notes.

In January 2002, the Company issued warrants to purchase common stock in exchange for an additional ninety days to become current with all past due interest payments related to notes issued in prior years.

During the year ended March 31, 2004, a noteholder converted $12,500 of 15% promissory notes including interest of $5,088 for 27,059 shares of common stock and 27,059 warrants to purchase shares of common stock at $0.65 per share (see Note 7). These warrants were valued using the Black Scholes option pricing model; the relative fair value was insignificant and was charged to interest expense upon grant.

During the year ended March 31, 2004, a noteholder converted an aggregate of $25,000 of 15% promissory notes including interest of $9,766 for 139,063 shares of common stock and 139,063 warrants to purchase shares of common stock at $0.25 per share (see Note 7). These warrants were valued using the Black Scholes option pricing model; the relative fair value was insignificant and charged to interest expense upon grant. A beneficial conversion feature approximating $37,500 was recorded during the year ended March 31, 2004 related to the conversion of 15% promissory notes.

All of the outstanding 15% Notes were past due and in default at March 31, 2004 and interest payable approximated $138,000 as of such date. Management's plans to satisfy the remaining outstanding balance on these notes include converting the notes to common stock at market value or repayment with available funds.

The total outstanding balance of the 15% Notes at March 31, 2004 was $335,000, which is included in notes payable in the accompanying consolidated balance sheet. The remaining $165,000 in notes payable in the accompanying consolidated balance sheet is comprised of the $150,000 9% Convertible Note (see Note 6), and two 10% Convertible Notes (see Note 6) totaling $15,000, all of which were no longer convertible as of March 31, 2004.

10% NOTES

In December 2002, an existing noteholder increased its advances to the Company by $40,000 to a total of $140,000. In consideration, the Company granted the noteholder warrants (see Note 7), cancelled the noteholder's existing $100,000 of convertible debt and replaced it with a secured $140,000 note payable. A BCF approximating $30,000 was recorded in connection with the issuance of the $140,000 note. The new note was paid by the Company in accordance with its terms

and as a result, there was no outstanding balance at March 31, 2004.

6.75% NOTES

On March 18, 2002, the Company issued a promissory note to a stockholder in the amount of $50,000, bearing interest at 6.75% per annum and maturing in May 2002. Such note was converted in March 2003 (see Note 7).

In May 2002, the Company issued notes payable totaling $25,000, bearing interest at 6.75% per annum, maturing in July 2002. The notes were converted into shares of the Company's common stock in March 2003 (see Note 7).

There were no amounts owed under the 6.75% Notes at March 31, 2004.

The Company is currently seeking other financing arrangements to retire all past due notes payable.

6. CONVERTIBLE NOTES PAYABLE

8% CONVERTIBLE NOTE

In November 2000, the Company issued convertible notes payable ("8% Convertible Notes") with original issue amounts totaling $395,000, bearing interest at 8% per annum, with principal and accrued interest due on November 1, 2002. The 8% Convertible Notes require no payment of principal or interest during the term and may be converted to common stock of the Company at any time at the option of the holder. The number of common shares issuable upon conversion is equal to the total principal and unpaid interest as of the date of conversion, divided by the conversion price. The conversion price per common share was changed effective August 31, 2001 to the lesser of (a) 80% of the closing market price for the common stock; or (b) 70% of the average of the three lowest closing market prices for the common stock for the ten trading days prior to conversion. Such change resulted in additional BCF approximating $57,000 during the year ended March 31, 2002.

During fiscal year 2002, the holder converted principal and accrued interest of approximately $49,000 into 40,267 shares of common stock, leaving principal of $350,000 and interest thereon due and outstanding. The average conversion price was approximately $1.22 per common share.

The 8% Convertible Notes required the Company to file an effective registration statement by February 2001. The Company filed a Form SB-2 with the SEC in December 2000; however, such registration statement was never declared effective and was subsequently abandoned. However, as the underlying securities are no longer restricted under Rule 144 of the Securities Act of 1933, the Company no longer plans on filing a registration statement in connection with this transaction. The Company accrued and expensed penalties approximating $150,000 at March 31, 2004 in connection with not filing an effective registration statement. The Company does not believe it will incur any additional charges and is in the process of renegotiating all penalties that have been recorded to date.

In March 2004, the noteholder converted $225,000 of principal and accrued

interest in the amount of $59,827 into 813,790 shares of common stock.

At March 31, 2004, there was one outstanding 8% Convertible Note with a balance of $125,000, which is included in convertible notes payable in the accompanying consolidated balance sheets. Interest payable on such note totaled $17,143 at March 31, 2004.

9% CONVERTIBLE NOTE

In April 2003, the Company issued a convertible note in the amount of $150,000 ("9% Convertible Note"), bearing interest at 9% per annum, with principal and interest due in June 2003, which is in default. The 9% Convertible Note required no payment of principal or interest during the term and was convertible into common stock of the Company at the conversion price of $0.25 per share through June 2003 at the option of the shareholder. The Company has recorded a BCF of $150,000 in connection with the issuance of the note and amortized such amount to interest expense upon issuance based on the related conversion feature. As this note is no longer convertible, the outstanding balance totaling $150,000 has been recorded as notes payable in the accompanying consolidated balance sheet. Accrued interest payable on this note approximated $13,500 at March 31, 2004. Therefore, there were no remaining 9% Convertible Notes outstanding as of March 31, 2004.

6. CONVERTIBLE NOTES PAYABLE (continued)

10% CONVERTIBLE NOTES

>From time to time, the Company issued convertible notes payable ("10% Convertible Notes") to various investors, bearing interest at 10% per annum, with principal and interest due six months from the date of issuance. The 10% Convertible Notes require no payment of principal or interest during the term and may be converted to common stock of the Company at the conversion price of $0.50 per share at any time at the option of the noteholder. The total amount of the original notes issued was $275,000.

In April 2002, the Company issued a 10% Convertible Note in the amount of $50,000. The conversion price of this note was $1.25 at the time of issuance, but in August 2002, the Company reduced the conversion price to $0.50.

During the year ended March 31, 2003, the Company issued additional 10% Convertible Notes totaling $225,000, of which $30,000 was converted into restricted common stock (see Note 7).

In November 2003, a noteholder converted $5,000 of principal and accrued interest of $509 for 11,017 shares of common stock.

In December 2003, a noteholder converted $100,000 of principal and accrued interest of $15,416 for 461,667 shares of common stock and 461,667 warrants to purchase common stock at $0.25 per share (see Note 7). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata fair value was insignificant and was charged to interest expense upon grant.

In January 2004, two noteholders converted $35,000 of principal and accrued

interest of $5,333 for 161,334 shares of common stock and 161,334 warrants to purchase common stock at $0.25 per share (see Note 7). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata fair value was insignificant and was charged to interest expense upon grant.

In March 2004, the Company borrowed $50,000 under a non-interest bearing convertible note payable, which was due in April 2004. In June 2004, the note was converted into common stock of the Company at $0.44 per share, in connection with the Company's private placement (see Note 11).

In March 2004, a noteholder converted $5,000 of principal and accrued interest of $696 for 13,725 shares of common stock and 13,725 warrants to purchase common stock at $0.42 per share (see Note 7). These warrants were valued using the Black Scholes option pricing model, the relative pro-rata fair value was insignificant, and charged to interest expense upon grant.

A BCF approximating $137,000 and $150,000 was recorded during each of the years ended March 31, 2004 and 2003, respectively related to the issuance of 10% Convertible Notes.

All of the 10% Convertible Notes, except the $50,000 borrowed in March 2004, were past due and in default at March 31, 2004. As two of these notes were no longer convertible at March, 31, 2004, the outstanding balances totaling $15,000 are included in notes payable in the accompanying consolidated balance sheet (see Note 5). At March 31, 2004, interest payable on these notes totaled $4,125. At March 31, 2004, there was one remaining outstanding 10% Convertible Note with a balance of $50,000 and interest payable totaling $2,083. Management's plans to satisfy the remaining outstanding balance on this note include converting the note to common stock at market value or repayment with available funds.

At March 31, 2004 convertible notes payable in the accompanying consolidated balance sheet totaling $175,000 is comprised of the only remaining 8% Convertible Note and the only remaining 10% Convertible Note with outstanding balances totaling $125,000 and $50,000, respectively (see above).

7. EQUITY TRANSACTIONS

COMMON STOCK

During the year ended March 31, 2003, the Company issued 150,124 shares of restricted common stock in connection with the conversion of amounts owed to certain vendors and noteholders approximating $188,000 (see Note 4).

During the year ended March 31, 2003, the Company issued 200,000 shares of restricted common stock for cash totaling $100,000 in connection with the exercise of warrants.

During the year ended March 31, 2003, the Company issued 461,600 shares of restricted common stock at $0.25 per share for cash totaling $115,400. In connection with the issuance of certain shares, the Company granted the stockholders warrants to purchase common stock of the Company at $0.25 per share. The warrants vested immediately and expire through March 2004 (see below).

During the year ended March 31, 2003, the Company issued 19,230 shares of restricted common stock at $0.26 per share for cash totaling $5,000.

During the year ended March 31, 2003, the Company issued 8,000 shares of restricted common stock at $1.25 for cash totaling $10,000.

During the year ended March 31, 2003, the Company issued 420,000 shares of restricted common stock in connection with the conversion of $75,000 of 6.75% Notes payable and $30,000 of 10% Convertible Notes (see Notes 4 and 5).

During the year ended March 31, 2003, the Company issued 69,231 shares of restricted common stock for consulting services valued at $45,000 (estimated based on the market price on the date of issue) and recorded such amount as professional fees in the accompanying consolidated financial statements.

During the year ended March 31, 2003, the Company issued 196,078 shares of restricted common stock in connection with the acquisition of a patent in 2000 (see Notes 8 and 12). Such shares were recorded at par value since the original patent acquisition purchase transaction had been measured at $100,000 and recorded as "patents" in the March 2000 consolidated balance sheet. The 196,078 shares merely satisfied a contingent obligation under the original purchase agreement.

During the year ended March 31, 2004, the Company issued 540,000 shares of restricted common stock for cash totaling $135,000 in connection with the exercise of warrants at $0.25 per share.

During the year ended March 31, 2004, the Company issued 1,226,000 shares of restricted common stock at $0.25 per share for cash totaling $306,500. In connection with the issuance of common stock, the Company granted the stockholders warrants to purchase 1,226,000 shares of common stock. The warrants vested upon grant and expire through January 2005.

During the year ended March 31, 2004, the Company issued 180,000 shares of restricted common stock at $0.30 per share for cash totaling $54,000. In connection with the issuance of common stock, the Company granted the stockholders warrants to purchase 180,000 shares of common stock. The warrants vested upon grant and expire through March 2005.

7. EQUITY TRANSACTIONS (continued)

COMMON STOCK (CONTINUED)

During the year ended March 31, 2004, the Company issued 40,000 shares of restricted common stock at $0.525 per share for cash totaling $21,000. In connection with the issuance of common stock, the Company granted the stockholders warrants to purchase 40,000 shares of common stock. The warrants vested upon grant and expire through March 2005.

During the year ended March 31, 2004, the Company issued 5,000 shares of restricted common stock at $1.125 per share for cash totaling $5,625. In connection with the issuance of common stock, the Company granted the

stockholders warrants to purchase 5,000 shares of common stock. The warrants vested upon grant and expire through March 2005.

During the year ended March 31, 2004, the Company issued 10,000 shares of restricted common stock at $0.25 for services valued at $2,500.

During the year ended March 31, 2004, the Company issued 73,529 shares of restricted common stock at $0.34 for services valued at $25,000.

During the year ended March 31, 2004, the Company issued 62,000 shares of restricted common stock at $0.40 for services valued at $24,825.

During the year ended March 31, 2004, the Company issued 185,185 shares of restricted common stock at $0.45 for services valued at $83,333.

During the year ended March 31, 2004, the Company issued 5,000 shares of restricted common stock at $0.50 for services valued at $2,500.

During the year ended March 31, 2004, noteholders converted $504,135 of principal and interest into 1,627,655 shares of common stock (see Notes 5 and 6) and warrants to purchase 802,848 shares of common stock (see "Warrants" below).

WARRANTS

In January 2002, the Company issued 335,000 warrants to purchase common stock in exchange for an additional ninety days to become current on all past due interest payments (see Note 5). The warrants have an exercise price of $2.00 per share, vest immediately, and expired twelve months from the date of issuance. Such warrants were valued using the Black-Scholes option pricing model at approximately $118,000, and were recorded as interest expense.

During the year ended March 31, 2002, the Company granted 239,000 warrants for services and the satisfaction of certain liabilities. The warrants have exercise prices ranging from $2.75 through $6.50 per common share, vested immediately and are exercisable through January 2007. The warrants were valued at $118,000, of which $78,000 was recorded as accounts payable and accrued liabilities in fiscal year 2001.

In August 2002, the Company granted warrants to purchase 52,000 shares of the Company's restricted common stock at an exercise price of $0.25 per share in connection with equity fund raising activities. These warrants vested upon grant and were exercisable through March 2004. As such warrants were issued in connection with equity fund raising activities, there was no expense recorded in the accompanying consolidated financial statements.

7. EQUITY TRANSACTIONS (continued)

WARRANTS (CONTINUED)

In December 2002, the Company issued 580,000 warrants to purchase common stock for $0.25 per share, which are exercisable through December 2007 and vested upon grant. The warrants were issued in connection with a short-term secured note payable (see Note 5). In accordance with GAAP, the proceeds of the financing

have been allocated to the debt and the warrants based on their relative estimated fair values. Accordingly, a discount of $30,000 has been recorded as a reduction of the debt balance and the off-setting credit has been reported as additional paid-in capital. The debt discount was amortized to interest expense in the year ended March 31, 2003 in accordance with the short-term nature of the note payable.

During the year ended March 31, 2003, the Company granted 240,830 warrants to investors in connection with the purchase of common stock. The warrants have an exercise price of $0.25 per share, vest immediately and were exercisable through March 2004. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements.

During the year ended March 31, 2003, the Company granted 75,061 warrants to certain vendors in connection with the conversion of amounts owed by the Company into common stock. The warrants were valued at $71,000 (estimated based on the relative fair values as determined by the Black Scholes option pricing model pursuant to SFAS 123), have exercise prices of $2.00, vest immediately and are exercisable through June 2005.

In March 2003, the Company issued 420,000 warrants to purchase common stock for $0.25 per share, which were exercisable through March 2004 and vested upon grant. The warrants were issued in connection with the conversion of notes payable (see Notes 5 and 6). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata estimated fair value was insignificant; and was charged to interest expense upon grant.

During the year ended March 31, 2004, the Company granted 1,226,000 warrants to investors in connection with the purchase of common stock. The warrants have an exercise price of $0.25 per share, vest immediately and are exercisable through March 2005. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements.

During the year ended March 31, 2004, the Company granted 180,000 warrants to investors in connection with the purchase of common stock. The warrants have an exercise price of $0.30 per share, vest immediately and are exercisable through March 2005. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements.

During the year ended March 31, 2004, the Company granted 40,000 warrants to investors in connection with the purchase of common stock. The warrants have an exercise price of $0.525 per share, vest immediately and are exercisable through March 2005. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements.

During the year ended March 31, 2004, the Company granted 5,000 warrants to investors in connection with the purchase of common stock. The warrants have an exercise price of $1.125 per share, vest immediately and are exercisable through March 2005. As the warrants were issued in connection with equity financing, no expense has been recorded in the accompanying consolidated financial statements.

As noted under "Common Stock" above, 540,000 of the warrants granted to investors in connection with the purchase of common stock during the year ended March 31, 2004 were exercised.

MARCH 31, 2004

7. EQUITY TRANSACTIONS (continued)

WARRANTS (CONTINUED)

During the year ended March 31, 2004, the Company issued 762,064 warrants to purchase common stock for $0.25 per share, which are exercisable through March 2005 and vested upon grant. The warrants were issued in connection with the conversion of notes payable (see Notes 5 and 6). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata estimated fair value was insignificant and was charged to interest expense upon grant.

In the year ended March 31, 2004, the Company issued 13,725 warrants to purchase common stock for $0.42 per share, which are exercisable through March 2005 and vested upon grant. The warrants were issued in connection with the conversion of notes payable (see Notes 5 and 6). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata estimated fair value was insignificant and was charged to interest expense upon grant.

In the year ended March 31, 2004, the Company issued 27,059 warrants to purchase common stock for $0.65 per share, which vested upon grant and expire through March 2005. The warrants were issued in connection with the conversion of notes payable (see Notes 45and 6). These warrants were valued using the Black Scholes option pricing model; the relative pro-rata fair estimated value was insignificant and was charged to interest expense upon grant.

A summary of the aggregate warrant activity for the years ended March 31, 2004 and 2003 is presented below:

	Year Ended March 31,			
	2004		2003	
	Warrants	Weighted Average Exercise Price	Warrants	Weighted Average Exercise Price
Outstanding, beginning of year	2,906,746	$ 2.29	1,873,855	$ 3.65
Granted	2,253,848	0.29	1,367,891	0.35
Exercised	(540,000)	0.25	--	--
Cancelled/Forfeited	(827,400)	0.25	(335,000)	(2.00)
Outstanding, end of year	3,793,194	$ 2.22	2,906,746	$ 2.29
Exercisable, end of year	3,793,194	$ 2.22	2,906,746	$ 2.29
Weighted average estimated fair value of warrants granted		$ 0.40		$ 0.38

The following outlines the significant assumptions used to estimate the fair value information presented utilizing the Black-Scholes option pricing model:

	Years Ended March 31, 2004	2003
Risk free interest rate	2.50%	3.50%
Average expected life	3 years	2.5 years
Expected volatility	365%	210%
Expected dividends	None	None

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7. EQUITY TRANSACTIONS (continued)

WARRANTS (CONTINUED)

The detail of the warrants outstanding and exercisable as of March 31, 2004 is as follows:

	Warrants Outstanding			Warrants Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
$ 0.25	1,913,494	1.7	$ 0.25	1,913,494	$ 0.25
$0.30 - $1.13	265,784	0.7	$ 0.39	265,784	$ 0.39
$2.00 - $4.00	711,166	1.3	$ 2.33	711,166	$ 2.33
$5.00 - $6.50	902,750	1.0	$ 5.25	902,750	$ 5.25
	3,793,194			3,793,194	

OPTIONS

In August 2000, the Company adopted the 2000 Stock Option Plan ("Stock Option Plan"), which was approved by its stockholders in September 2000. The Stock Option Plan provides for the issuance of up to 500,000 options to purchase shares of common stock. Such options can be incentive options or nonstatutory options, and may be granted to employees, directors and consultants. The Stock Option Plan has limits as to the eligibility of those stockholders who own more than 10% of Company stock, as defined. The options granted pursuant to the Stock Option Plan may have exercise prices of no less than 100% of fair market value of the Company's common stock at the date of grant (incentive options), or no less than 75% of fair market value of such stock at the date of grant (nonstatutory).

In March 2002, the board of directors granted the Company's Chief Executive Officer ("CEO") and Dr. Tullis non-qualified stock options to purchase up to 250,000 shares of common stock each, at an exercise price of $1.90 per share (the estimated fair value at grant date) and expire March 2012. Awards are earned upon achievement of certain financial and/or research and development

milestones.

In January 2002, the Company granted 400,000 stock options to a consultant for services rendered valued at $562,000 (estimated based on the Black Scholes option pricing model pursuant to SFAS 123) in connection with a consulting agreement. In July 2002, the Company extended the original agreement by six months to expire July 2003 and granted an additional 200,000 stock options valued at $114,000 (estimated based on the Black Scholes option pricing model pursuant to SFAS 123). All 600,000 options have been exercised as of March 31, 2003. The stock options had an exercise price of $0.50, and vested on the grant dates.

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7. EQUITY TRANSACTIONS (continued)

OPTIONS (CONTINUED)

The following is a status of the stock options outstanding at March 31, 2004 and the changes during the two years then ended:

	Year Ended March 31,			
	2004		2003	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	1,376,115	$ 2.49	1,376,115	$ 2.49
Granted	--		200,000	0.50
Exercised	--		(200,000)	(0.50)
Cancelled/Forfeited	--		--	--
Outstanding, end of year	1,376,115	$ 2.49	1,376,115	$ 2.49
Exercisable, end of year	1,363,615	$ 2.51	1,283,530	$ 2.50
Weighted average estimated fair value of options granted		--		$ 0.57

The following outlines the significant assumptions used to estimate the fair value information presented utilizing the Black-Scholes option pricing model for the year ended March 31, 2003 (there were no issuances in fiscal 2004):

Risk free interest rate	3.50
Average expected life	3 years

Expected volatility	210%
Expected dividends	None

The detail of the options outstanding and exercisable as of March 31, 2004 is as follows:

	Options Outstanding			Options Exercisab	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Outstanding	Weigh Aver Exerc Pri
$0.39	50,848	4.7 years	$ 0.39	50,848	$ 0.3
$1.78 - $2.00	515,267	8.9 years	1.90	515,267	1.9
$2.25 - $3.00	602,500	4.3 years	2.78	590,000	2.7
$3.25 - $3.75	207,500	2.9 years	3.27	207,500	3.2
	1,376,115			1,363,615	

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8. RELATED PARTY TRANSACTIONS

DUE TO RELATED PARTIES

Certain officers of the Company and other related parties have advanced the Company funds, agreed to defer compensation and/or paid expenses on behalf of the Company to cover working capital deficiencies. These non interest-bearing liabilities have been included as due to related parties in the accompanying consolidated financial statements.

ROYALTY AGREEMENT AND PATENT ACQUISITION

Effective January 1, 2000, the Company entered into an agreement with Dr. Julian Ambrus, the son of Dr. Clara Ambrus, who was the original founder of Hemex, Inc. under which an invention and related patent rights for a method of removing HIV and other viruses from the blood using the Hemopurifier(TM) were assigned to the Company by the inventors in exchange for (a) a royalty to be paid on future sales of the patented product or process equal to 8.75% of net sales, as defined and (b) 12,500 shares of the Company's common stock. Upon the issuance of the first United States patent relating to the invention, the Company was obligated to issue additional shares of common stock to the inventors. If the market price of the Company's common stock on the date the patent is issued was below $8 per share, the number of shares to be issued was that amount which equates to $100,000 of market value. On March 4, 2003, the related patent was issued and therefore the Company issued 196,078 shares of common stock recorded at par value since the transaction was measured and reported as "patents" in fiscal 2000 for $100,000. (see Notes 7 and 12)

Other related party transactions are disclosed elsewhere in these notes to consolidated financial statements.

9. INCOME TAX PROVISION

Income tax expense for the years ended March 31, 2004 and 2003 differed from the amounts computed by applying the U.S. Federal income tax rate of 34 percent to the loss from continuing operations before provision for income taxes as a result of the following:

	2004	2003
Computed "expected" tax benefit	$ (516,000)	$ (837,000)
Reduction in income taxes resulting from:		
Equity instruments issued for services	--	39,000
Interest for warrants and BCF	94,000	85,000
Change in deferred tax assets valuation allowance	583,000	897,000
State and local income taxes, net of federal benefit	(134,000)	(162,000)
Other	(27,000)	(22,000)
	$ --	$ --

9. INCOME TAX PROVISION (continued)

The tax effects of temporary differences that give rise to significant portions of deferred tax assets at March 31, 2004 are presented below:

Deferred tax assets:	
Capitalized research and development	$ 1,833,000
Net operating loss carryforwards	2,977,000
Total gross deferred tax assets	4,810,000
Less valuation allowance	(4,810,000)
Net deferred tax assets	$ --

The valuation allowance for deferred tax assets from continuing operations as of March 31, 2004 and 2003 was $4,810,000 and $4,227,000, respectively.

As of March 31, 2004, the Company had tax net operating loss carryforwards of approximately $8,000,000 and $3,000,000 available to offset future taxable Federal and state income, respectively. The carryforward amounts expire in various years through 2024.

Due to the change in ownership provisions of the Tax Reform Act of 1986, net operating loss carryforwards for Federal income tax reporting purposes are subject to annual limitations. Should a change in ownership occur, net operating loss carryforwards may be limited as to use in future years.

10. COMMITMENTS AND CONTINGENCIES

REGISTRATION RIGHTS AGREEMENTS

The Company is obligated under various agreements to register its common stock, including the common stock underlying certain warrants and options. The Company is subject to penalties for failure to register such securities, the amount of which could be material to the Company's financial condition, results of operations and cash flows. The Company filed a registration statement on Form SB-2 with the SEC in December 2000 to register the necessary securities. However, such registration statement was never declared effective and subsequently abandoned. Management is currently unaware of any claims related to the lack of registration. However, as the underlying securities are no longer restricted under Rule 144 of the Securities Act of 1933, the Company no longer plans on filing a registration statement in connection with this transaction.

EMPLOYMENT CONTRACTS

In addition to the employment contract discussed in Note 3, the Company entered into an employment agreement with its Chairman of the Board effective April 1, 1999. The agreement, which is cancelable by either party upon sixty days notice, will be in effect until the employee retires or ceases to be employed by the Company. The Chairman of the Board was appointed President and Chief Executive Officer ("CEO") effective June 1, 2001 upon which the base annual salary was increased from $120,000 to $180,000. The CEO is eligible for an annual bonus at the discretion of the Board of Directors, of which nil was earned during each of the years ended March 31, 2004 and 2003, respectively. Under the terms of the agreement, if the employee is terminated he may become eligible to receive a salary continuation payment in the amount of at least twelve months' base salary.

11. SUBSEQUENT EVENTS (unaudited)

In June 2004, the Company completed a $673,000 private placement of common stock with accredited investors, including Fusion Capital Fund II, LLC, a Chicago-based investor. In connection with the private placement, the Company entered into a common stock purchase agreement with Fusion Capital, whereby Fusion Capital has committed to buy up to an additional $6,000,000 of the Company's common stock over a 30-month period, commencing, at the Company's election, after the SEC has declared effective a registration statement covering such shares. The funds the Company has received in connection with this financing, together with any additional funds the Company may receive from Fusion Capital under the common stock purchase agreement, will be used to fund the Company's research and development activities and anticipated operations for the future. The Company has issued 1,529,545 shares of common stock and 1,529,545 warrants to purchase common stock at $0.76 per share, which vested upon grant and are exercisable through May 2007, for the funds the Company has received in connection with this financing.

Subsequent to March 31, 2004, the Company issued 242,143 shares of restricted common stock at prices ranging from $0.44 to $1.75 per share for services approximating $129,000.

Subsequent to March 31, 2004, the Company issued 500,000 shares of restricted common stock for cash totaling $125,000 in connection with the exercise of

warrants at $0.25 per share.

12. PATENTS

GENERAL

Patents include both foreign and domestic patents. There were no patents or patents pending acquired during the years ended March 31, 2004 and 2003. Approximately $147,000 of patents pending were approved during fiscal 2003 (excluding the patent discussed in the following paragraph) and there were no patents pending at March 31, 2004 or 2003. The unamortized cost of patents and patents pending is written off when management determines there is no future benefit. During the years ended March 31, 2004 and 2003, zero and $334,000 of capitalized patent costs were written off, respectively. At March 31, 2004, the gross carrying amount of patents and the related accumulated amortization approximated $345,000 and $108,000, respectively. Amortization of patents and patents pending approximated $29,000 and $15,000 during the years ended March 31, 2004 and 2003, respectively. Amortization expense on patents is estimated to be approximately $23,000 per year for the next five fiscal years. The weighted average amortization period for patents was approximately 15 years at March 31, 2004.

RESTATEMENT

In August 2004, management determined that it had inadvertently recorded an additional $100,000 of expense in March 2003 related to the 196,078 shares issued in connection with the Company's acquisition of a patent (see Note 8). The March 31, 2004 consolidated balance sheet and statement of operations for the year ended March 31, 2003 have been restated accordingly. Such restatement reduced fiscal 2003 professional fees and net loss by $100,000 ($0.01) per common share) with a corresponding reduction to the previously reported accumulated deficit at March 31, 2004.