AETHLON MEDICAL INC
Form 10-Q
February 11, 2019

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2018

OR

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

For the transition period from _____to_____

COMMISSION FILE NUMBER 001-37487

AETHLON MEDICAL, INC.

(Exact name of registrant as specified in its charter)

NEVADA	13-3632859
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9635 GRANITE RIDGE DRIVE, SUITE 100, SAN DIEGO, CA 92123

(Address of principal executive offices) (Zip Code)

(858) 459-7800

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (ss.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES NO

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to section 13(a) of the Exchange Act.

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

As of February 11, 2019, the registrant had outstanding 18,960,505 shares of common stock, $0.001 par value.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2018 (Unaudited)	March 31, 2018
ASSETS		
Current assets		
Cash	$4,824,901	$6,974,070
Accounts receivable	–	74,813
Prepaid expenses and other current assets	35,067	181,367
Total current assets	4,859,968	7,230,250
Property and equipment, net	9,669	27,552
Patents, net	68,959	75,832
Deposits	12,159	18,270
Total assets	$4,950,755	$7,351,904
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$69,613	$124,450
Due to related parties	69,750	90,366
Convertible notes payable, net	932,014	–
Other current liabilities	709,348	263,141
Total current liabilities	1,780,725	477,957
Convertible notes payable, net	–	841,153
Total liabilities	1,780,725	1,319,110
Commitments and Contingencies (Note 13)		
Stockholders' Equity		
Common stock, par value $0.001 per share; 30,000,000 shares authorized as of December 31, 2018 and March 31, 2018; 18,577,123 and 17,739,511 shares issued	18,577	17,740

and outstanding as of December 31, 2018 and March 31, 2018, respectively		
Additional paid-in capital	107,283,829	105,574,014
Accumulated deficit	(104,010,327)	(99,457,714)
Total Aethlon Medical, Inc. stockholders' equity before noncontrolling interests	3,292,079	6,134,040
Noncontrolling interests	(122,049)	(101,246)
Total stockholders' equity	3,170,030	6,032,794
Total liabilities and stockholders' equity	$4,950,755	$7,351,904

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three and Nine Month Periods Ended December 31, 2018 and 2017

(Unaudited)

	Three Months Ended December 31, 2018	Three Months Ended December 31, 2017	Nine Months Ended December 31, 2018	Nine Months Ended December 31, 2017
REVENUES				
Government contract revenue	$–	$74,813	$149,625	$74,813
OPERATING EXPENSES				
Professional fees	587,192	439,117	1,449,218	1,165,318
Payroll and related expenses	1,161,531	663,245	2,426,828	1,911,553
General and administrative	215,150	136,078	681,678	557,991
Total operating expenses	1,963,873	1,238,440	4,557,724	3,634,862
OPERATING LOSS	(1,963,873)	(1,163,627)	(4,408,099)	(3,560,049)
OTHER EXPENSE				
Interest and other debt expenses	55,107	55,912	165,317	306,495
Loss on share for warrant exchanges	–	–	–	130,214
Loss on debt extinguishment	–	–	–	376,909
Total other expense	55,107	55,912	165,317	813,618
NET LOSS	(2,018,980)	(1,219,539)	(4,573,416)	(4,373,667)
LOSS ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(5,940)	(4,532)	(20,803)	(12,972)
NET LOSS ATTRIBUTABLE TO AETHLON MEDICAL, INC.	$(2,013,040)	$(1,215,007)	$(4,552,613)	$(4,360,695)
BASIC AND DILUTED LOSS PER COMMON SHARE	$(0.11)	$(0.08)	$(0.25)	$(0.40)
	18,050,165	14,950,701	17,865,176	10,927,106

WEIGHTED AVERAGE NUMBER OF COMMON
SHARES OUTSTANDING – BASIC AND DILUTED

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended December 31, 2018 and 2017

(Unaudited)

	Nine Months Ended December 31, 2018	Nine Months Ended December 31, 2017
Cash flows from operating activities:		
Net loss	$(4,573,416)	$(4,373,667)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	24,756	27,402
Stock based compensation	944,512	887,607
Common stock issued for services	19,350	33,600
Loss on share for warrant exchanges	–	130,214
Loss on debt extinguishment	–	376,909
Amortization of debt discount	90,861	215,376
Changes in operating assets and liabilities:		
Accounts receivable	74,813	–
Prepaid expenses and other current assets	152,411	23,014
Accounts payable and other current liabilities	391,369	(219,806)
Due to related parties	(20,616)	6,600
Net cash used in operating activities	(2,895,960)	(2,892,751)
Cash flows from investing activities:		
Purchases of property and equipment	–	(23,705)
Net cash used in investing activities	–	(23,705)
Cash flows from financing activities:		
Proceeds from the issuance of common stock, net	883,500	7,166,081
Tax withholding payments or tax equivalent payments for net share settlement of restricted stock units	(136,709)	(198,527)
Net cash provided by financing activities	746,791	6,967,554
Net (decrease) increase in cash	(2,149,169)	4,051,098
Cash at beginning of period	6,974,070	1,559,701

Cash at end of period	$4,824,901	$5,610,799
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$95,388	$–
Supplemental disclosures of non-cash investing and financing activities:		
Issuance of shares under conversions of convertible notes payable and related accrued interest	$–	$362,765
Issuance of shares from vesting of restricted stock units	$138	$120

See accompanying notes.

AETHLON MEDICAL, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

December 31, 2018

1. NATURE OF BUSINESS AND BASIS OF PRESENTATION

ORGANIZATION

Aethlon Medical, Inc. and its subsidiary (collectively, “Aethlon”, the “Company”, “we” or “us”) is a medical technology company focused on addressing unmet needs in global health and biodefense. The Aethlon Hemopurifier® is a clinical-stage immunotherapeutic device designed to combat cancer and life-threatening viral infections. In cancer, the Hemopurifier depletes the presence of circulating tumor-derived exosomes that promote immune suppression, seed the spread of metastasis and inhibit the benefit of leading cancer therapies. The U.S. Food and Drug Administration (FDA) has designated the Hemopurifier as a "Breakthrough Device" related to the following two indications:

- the treatment of life-threatening viruses that are not addressed with approved therapies; and
- the treatment of individuals with advanced or metastatic cancer who are either unresponsive to or intolerant of standard of care therapy, and with cancer types in which exosomes have been shown to participate in the development or severity of the disease.

We believe the Hemopurifier can be a part of the broad-spectrum treatment of life-threatening highly glycosylated viruses that are not addressed with an already approved treatment countermeasure objective set forth by the U.S. Government to protect citizens from bioterror and pandemic threats. In small-scale or early feasibility human studies, the Hemopurifier has been administered to individuals infected with HIV, hepatitis-C, and Ebola. Additionally, the Hemopurifier has been validated to capture Zika virus, Lassa virus, MERS-CoV, cytomegalovirus, Epstein-Barr virus, Herpes simplex virus, Chikungunya virus, Dengue virus, West Nile virus, smallpox-related viruses, H1N1 swine flu virus, H5N1 bird flu virus, and the reconstructed Spanish flu virus of 1918. In several cases, these validations were conducted in collaboration with leading government or non-government research institutes. Domestically, we are focused on the clinical advancement of the Hemopurifier through investigational device exemptions (IDEs) approved by the FDA. We recently concluded a feasibility study to demonstrate the safety of our device in health-compromised individuals infected with a viral pathogen.

We are also the majority owner of Exosome Sciences, Inc. (ESI), a company focused on the discovery of exosomal biomarkers to diagnose and monitor life-threatening diseases. Included among ESI's endeavors is the advancement of a TauSome™ biomarker candidate to diagnose chronic traumatic encephalopathy (CTE) in the living. ESI previously documented TauSome levels in former NFL players to be nine times higher than same age-group control subjects.

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

Our executive offices are located at 9635 Granite Ridge Drive, Suite 100, San Diego, California 92123. Our telephone number is (858) 459-7800. Our website address is www.aethlonmedical.com.

Our common stock is listed on the Nasdaq Capital Market under the symbol "AEMD."

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

During the nine months ended December 31, 2018, there have been no changes to our significant accounting policies as described in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 8 of the Securities and Exchange Commission (SEC) Regulation S-X. Accordingly, they should be read in conjunction with the audited financial statements and notes thereto for the year ended March 31, 2018, included in the Company's Annual Report on Form 10-K filed with the SEC on June 8, 2018. The accompanying unaudited condensed consolidated financial statements include the accounts of Aethlon Medical, Inc. and its majority-owned subsidiary. All significant inter-company transactions and balances have been eliminated in consolidation. The unaudited condensed consolidated financial statements contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly the condensed consolidated financial statements as of and for the nine months ended December 31, 2018, and the condensed consolidated statement of cash flows for the nine months ended December 31, 2018. Estimates were made relating to useful lives of fixed assets, impairment of assets, share-based compensation expense and accruals for clinical trial and research and development expenses. Actual results could differ materially from those estimates. The accompanying condensed consolidated balance sheet at March 31, 2018 has been derived from the audited consolidated balance sheet at March 31, 2018, contained in the above referenced 10-K. The results of operations for the nine months ended December 31, 2018 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

LIQUIDITY

Management expects existing cash as of December 31, 2018 to be sufficient to fund the Company’s operations for at least twelve months from the issuance date of these condensed consolidated financial statements.

2. LOSS PER COMMON SHARE

Basic loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period of computation. The weighted average number of common shares outstanding for the three and nine months ended December 31, 2018 and 2017 included 46,125 vested restricted stock units. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional dilutive common shares that would have been outstanding if potential common shares had been issued, if such additional common shares were dilutive. Since we had net losses for all periods presented, basic and diluted loss per share are the same, and additional potential common shares have been excluded as their effect would be antidilutive.

As of December 31, 2018 and 2017, a total of 6,886,020 and 9,143,480 potential common shares, respectively, consisting of shares underlying outstanding stock options, warrants, unvested restricted stock units and convertible notes payable, were excluded as their inclusion would be antidilutive.

3. RESEARCH AND DEVELOPMENT EXPENSES

Our research and development costs are expensed as incurred. We incurred research and development expenses during the three and nine month periods ended December 31, 2018 and 2017, which are included in various operating expense line items in the accompanying condensed consolidated statements of operations. Our research and development expenses in those periods were as follows:

	December 31, 2018	December 31, 2017
Three months ended	$243,843	$129,207
Nine months ended	$655,760	$462,640

4. FUTURE ACCOUNTING PRONOUNCEMENTS

ASU 2016-02, Leases (Topic 842) changes the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption of ASU 2016-02 as of its issuance is permitted. We are evaluating the impact the adoption of ASU 2016-02 will have on our financial statements and disclosures.

5. CONVERTIBLE NOTES PAYABLE, NET

Convertible Notes Payable, Net consisted of the following at December 31, 2018:

	Principal	Unamortized Discount	Net Amount	Accrued Interest
Convertible Notes Payable, Net:				
November 2014 10% Convertible Notes (due July 1, 2019)	$612,811	$ (37,399)	$575,412	$21,987
December 2016 10% Convertible Notes (due July 1, 2019)	379,780	(23,178)	356,602	12,771
Total Convertible Notes Payable, Net	$992,591	$ (60,577)	$932,014	$34,758

During the nine months ended December 31, 2018, we recorded interest expense of $74,445 related to the contractual interest rates of our convertible notes and interest expense of $90,861 related to the amortization of the note discount for a total interest expense of $165,306 related to our convertible notes in the nine months ended December 31, 2018. All of the unamortized discount at December 31, 2018 related to the note discount established upon the June 2017 amendment to the November 2014 10% Convertible Notes and to the December 2016 10% Convertible Notes (see below).

Convertible Notes Payable, Net consisted of the following at March 31, 2018:

	Principal	Unamortized Discount	Net Amount	Accrued Interest
Convertible Notes Payable, Net – Non-Current Portion:				
November 2014 10% Convertible Notes (due July 1, 2019)	$612,811	$ (93,590)	$519,221	$34,386
December 2016 10% Convertible Notes (due July 1, 2019)	379,780	(57,848)	321,932	21,315
Total Convertible Notes Payable, Net	$992,591	$ (151,438)	$841,153	$55,701

During the nine months ended December 31, 2017, we recorded interest expense of $87,641 related to the contractual interest rates of our convertible notes and interest expense of $215,376 related to the amortization of the note discount for a total interest expense of $303,017 related to our convertible notes. All of the unamortized discount at December 31, 2017 related to the note discount established upon the June 2017 amendment to both the November 2014 10% Convertible Notes and the December 2016 10% Convertible Notes (see below).

NOVEMBER 2014 10% CONVERTIBLE NOTES

In November 2014, we entered into a subscription agreement with two accredited investors providing for the issuance and sale of (i) convertible promissory notes in the aggregate principal amount of $527,780 (the “Notes”) and (ii) five year warrants to purchase up to 47,125 shares of common stock at a fixed exercise price of $8.40 per share (the “Warrants”). These Notes bear interest at the annual rate of 10% and originally matured on April 1, 2016.

The aggregate gross cash proceeds to us were $415,000 after subtracting legal fees of $35,000, a $27,780 due diligence fee and an original issuance discount of $50,000. We recorded deferred financing costs of $112,780 to reflect the legal fees, due diligence fee and original issuance discount and will amortize those costs over the life of the Notes using the effective interest method.

These Notes were originally convertible at the option of the holders into shares of our common stock at a fixed price of $5.60 per share, for up to an aggregate of 94,246 shares of common stock. There are no registration requirements with respect to the shares of common stock underlying the Notes or the Warrants.

The estimated relative fair value of the Warrants issued in connection with the Notes was recorded as a debt discount and is amortized as additional interest expense over the term of the underlying debt. We recorded debt discount of $240,133 based on the relative fair value of these Warrants. In addition, as the effective conversion price of the Notes was less than market price of the underlying common stock on the date of issuance, we recorded an additional debt discount of $287,647 related to the beneficial conversion feature.

Initial Amendment of the November 2014 10% Convertible Note Terms

On November 12, 2015, we entered into an amendment of terms ("Amendment of Terms") with the two investors that participated in the November 2014 10% Convertible Notes. The Amendment of Terms modified the terms of the subscription agreement, Notes and Warrants held by those investors to, among other things, extended the maturity date of the Notes from April 1, 2016 to June 1, 2016, temporarily reduced the number of shares that we must reserve with respect to conversion of the Notes, and temporarily suspended the time period during which one of the investors may exercise its Warrants. In exchange for the investors' agreements in the Amendment of Terms, we paid one of the investors a cash fee of $90,000, which we recorded as deferred financing costs and amortized over the remaining term of the Notes.

Second Amendment and Extension of the November 2014 10% Convertible Notes

On June 27, 2016, we and certain investors entered into further amendments (the "Amendments") to the Notes and the Warrants. The Amendments provide that the maturity date was extended from June 1, 2016 to July 1, 2017 and that the conversion price per share of the Notes was reduced from $5.60 per share of common stock to $5.00 per share of common stock. In addition, we reduced the exercise price set forth in the Warrants from $8.40 per share to $5.00 per share of common stock. In connection with these modifications, each of the investors signed a Consent and Waiver providing its consent under certain restrictive provisions, and waiving certain rights, including a right to participate in certain offerings made by us, under a Securities Purchase Agreement dated June 23, 2015 (the "2015 SPA") to which we, the investors and certain other investors are parties, in order to facilitate an at-the-market equity program.

The Amendments also increased the principal amount of the Notes to $692,811 (in the aggregate) to (i) include accrued and unpaid interest through June 15, 2016, and (ii) increase the principal amount by $80,000 (in the aggregate) as an extension fee for the extended maturity date of the Notes. With respect to each Note, we entered into an Allonge to Convertible Promissory Note (each, an "Allonge") reflecting the changes in the principal amount, maturity date and conversion price of the Note.

We also issued to the investors new warrants (the "New Warrants") to purchase an aggregate of 30,000 shares of common stock with an exercise price of $5.00 per share of common stock. We issued the New Warrants in substantially the same form as the prior Warrants, and the New Warrants will expire on November 6, 2019, the same date on which the prior Warrants will expire.

The modification of the Notes was evaluated under FASB Accounting Standards Codification ("ASC") Topic No. 470-50-40, "Debt Modification and Extinguishments" ("ASC 470-50-40"). Therefore, according to the guidance, the

instruments were determined to be substantially different, and the transaction qualified for extinguishment accounting. As a result, we recorded a loss on debt extinguishment of $536,889 and recognized an extension fee expense of $80,000, which are included in other (income) expenses in the accompanying condensed consolidated statements of operations. The debt extinguishment is comprised from the fair value of prior warrants issued in connection with the Notes of $287,676, as well as $325,206 related to beneficial conversion feature and offset by debt discount of $75,993. The beneficial conversion feature is a result of the effective conversion price of the new Notes being less than the market price of the underlying common stock on the date of modification.

Third Amendment and Extension of the November 2014 10% Convertible Notes

In connection with the issuance of the December 2016 10% Convertible Notes, the conversion price of the Notes was reduced from $5.00 to $4.00 per share and the maturity date of the Notes was extended from July 1, 2017 to July 1, 2018.

The modification of the Notes was evaluated under ASC 470-50-40 and the instruments were determined to be substantially different, and the transaction qualified for extinguishment accounting. As a result, we recorded a gain on debt extinguishment of $58,691, which is included in other (income) expenses in the accompanying condensed consolidated statements of operatio