AETHLON MEDICAL INC
Form SB-2
April 04, 2007

As filed with the Securities and Exchange Commission on April 4, 2007
Commission File No. 333-

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

FORM SB-2
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

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.)

3826
(PRIMARY STANDARD INDUSTRIAL CLASSIFICATION CODE NUMBER)

JAMES A. JOYCE
CHIEF EXECUTIVE OFFICER
3030 BUNKER HILL STREET, SUITE 4000
SAN DIEGO, CALIFORNIA 92109
(858) 459-7800

(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

(NAME, ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF AGENT FOR SERVICE OF PROCESS)

Copies to

NIMISH PATEL, ESQ.
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Approximate date of proposed sale to public: From time to time after the effective date of this registration statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans check the following box. [X]

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]_____

If this Form is a post effective amendment filed pursuant to Rule 462(c) under

the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: [ ]_____

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: [ ]_____

If delivery of this prospectus is expected to be made pursuant to Rule 434, please check the following box: [ ]

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED	PROPOSED MAXIMUM OFFERING PRICE PER UNIT	PROPOSED MAXIMU AGGREGATE OFFERING PRICE
Common Shares	8,383,333(2)	$ 0.735(1)	$6,161,75
Total	8,383,333	$ 0.735	$6,161,75

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) of Regulation C as of the close of the market on April 2, 2007, based upon the average of the high and low prices for that date.

(2) 8,383,333 common shares issued or issuable to Fusion Capital Fund II, LLC under a common stock purchase agreement.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

PRELIMINARY PROSPECTUS SUBJECT TO COMPLETION, DATED APRIL 4, 2007

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND WE ARE NOT SOLICITING OFFERS TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

PROSPECTUS

AETHLON MEDICAL, INC.

8,383,333 Shares of Common Stock

This prospectus relates to the sale of up to 8,383,333 shares of our common stock by Fusion Capital Fund II, LLC. Fusion Capital is sometimes referred to in this prospectus as the selling shareholder. The prices at which Fusion Capital may sell the shares will be determined by the prevailing market price for the shares or in negotiated transactions. We will not receive proceeds from the sale of our shares by Fusion Capital.

Our common stock is registered under Section 12(g) of the Securities Exchange Act of 1934 and quoted on the Over-The-Counter Bulletin Board under the symbol "AEMD.OB" On April 2, 2007, the last reported sale price for our common stock as reported on the Over-The-Counter Bulletin Board was $0.72 per share.

Investing in our common stock involves certain risks. See "Risk Factors" beginning on page 2 for a discussion of these risks.

The selling shareholder is an "underwriter" within the meaning of the Securities Act of 1933, as amended.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus is _____, 2007.

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PROSPECTUS SUMMARY

This summary highlights important information about our company and business. Because it is a summary, it may not contain all of the information that is important to you. To understand this offering fully, you should read this entire prospectus and the financial statements and related notes included in this prospectus carefully, including the "Risk Factors" section. Unless the context requires otherwise, "WE," "US," "OUR", " and the "COMPANY" and similar terms collectively refer to Aethlon Medical, Inc.

THE COMPANY

We are a development stage medical device company focused on expanding the applications of our Hemopurifier (R) 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 acute viral conditions, chronic viral diseases and pathogens targeted as potential biological warfare agents. The Hemopurifier(R) combines the established scientific principles of affinity chromatography and hemodialysis as a means to mimic the immune system's response of clearing viruses and toxins from the blood before cell and organ infection can occur. The Hemopurifier(R) cannot cure viral conditions but can prevent virus and toxins from infecting unaffected tissues and cells. We have completed pre-clinical blood testing of the Hemopurifier(R) to treat HIV and Hepatitis-C, and have completed human safety trials on Hepatitis-C infected patients in India and are in the process of obtaining regulatory approval from the U.S. Food and Drug Administration ("FDA")to initiate clinical trials in the United States.

The commercialization of the Hemopurifier(R) will likely require the completion of human efficacy clinical trials. The approval of any application of the Hemopurifier(R) in the United States will necessitate the approval of the FDA to initiate human studies. Such studies could take years to demonstrate safety and effectiveness in humans and there is no assurance that the Hemopurifier(R) will be cleared by the FDA as a device we can market to the medical community. We also expect to face similar regulatory challenges from foreign regulatory agencies, should we attempt to commercialize and market the Hemopurifier(R) outside of the United States. As a result, we have not generated revenues from the sale of any Hemopurifier(R) application. Additionally, there have been no independent validation studies of our Hemopurifiers(R) to treat

infectious disease. We manufacture our products on a small scale for testing purposes but have yet to manufacture our products on a large scale for commercial purposes. All of our pre-clinical human blood studies have been conducted in our laboratories under the direction of Dr. Richard Tullis, our Chief Science Officer.

As of March 27, 2007, we had issued and outstanding 32,518,548 common shares, and common share purchase options and warrants entitling the holders to purchase up to 20,054,309 common shares. We are a Nevada corporation. Our principal executive offices are located at 3030 Bunker Hill Street, Suite 4000, San Diego, California 92109. Our telephone number is (858) 459-7800. The address of our website is www.aethlonmedical.com. Information on our website is not a part of this prospectus.

THE OFFERING

Fusion Capital, the selling shareholder under this prospectus, is offering for sale up to 8,383,333 shares of our common stock hereto. On March 21, 2007, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC, an Illinois limited liability company. Under the agreement, Fusion Capital is obligated, under certain conditions, to purchase shares from us in an aggregate amount of $8.4 million from time to time over a 25 month period. On March 27, 2007, we sold 1,333,333 shares of common stock to Fusion Capital under the agreement for total proceeds of $400,000. Under the terms of the common stock purchase agreement, Fusion Capital has received a commitment fee consisting of 1,050,000 shares of our common stock. We have reserved up to an additional 6,000,000 shares of our common stock for sale to Fusion Capital under the agreement. As of March 27, 2007, there were 32,518,548 shares outstanding (27,587,195 shares held by non-affiliates) excluding the 6,000,000 shares offered by Fusion Capital pursuant to this prospectus which it has not yet purchased from us. If all of such 8,383,333 shares offered hereby were issued and outstanding as of the date hereof, the 8,383,333 shares would represent approximately 21.8% of the total common stock outstanding or approximately 24.96% of the non-affiliate shares outstanding as of March 27, 2007. The number of shares ultimately offered for sale by Fusion Capital is dependent upon the number of shares purchased by Fusion Capital under the agreement.

We do not have the right to make any additional sales of our shares to Fusion Capital unless and until the US Securities & Exchange Commission has declared effective the registration statement of which this prospectus is a part of. After the Securities & Exchange Commission has declared effective such registration statement, generally we will have the right, but not the obligation, from time to time to sell our shares to Fusion Capital in amounts between $32,000 and $1.0 million depending on certain conditions. We have the right to control the timing and amount of any sales of our shares to Fusion Capital. The purchase price of the shares will be determined based upon the market price of our shares without any fixed discount at the time of each sale. Fusion Capital shall not have the right nor the obligation to purchase any shares of our common stock on any business day that the price of our common stock is below $0.25. The agreement may be terminated by us at any time at our discretion without any cost to us.

SUMMARY FINANCIAL DATA

The following tables summarize the consolidated statements of operations and balance sheet data for our company.

CONSOLIDATED STATEMENTS OF OPERATIONS DATA:	NINE MONTHS ENDED DECEMBER 31, (UNAUDITED)	
	2006	2005
Revenue	$ 0	$ 0
Gross profit	$ 0	$ 0
Net loss	(1,787,569)	$ (2,069,698)
Preferred stock dividends	N/A	N/A
Net loss attributed to common shareholders	$ (1,787,569)	$ (2,069,698)
Loss per common share, basic and diluted	$ (0.07)	$ (0.11)
Weighted average common shares outstanding, basic and diluted	27,174,574	18,744,309

CONSOLIDATED BALANCE SHEET DATA:	DECEMBER 31, 2006 (UNAUDITED)
Current assets	$ 61,746
Total assets	$ 226,173
Total current liabilities	$ 2,929,640
Total stockholders' deficit	$(2,703,467)
Total liabilities and stockholders' deficit	$ 226,173

RISK FACTORS

An investment in our common shares involves a high degree of risk and is subject to many uncertainties. These risks and uncertainties may adversely affect our business, operating results and financial condition. In such an event, the trading price for our common shares could decline substantially, and you could lose all or part of your investment. In order to attain an appreciation for these risks and uncertainties, you should read this prospectus in its entirety and consider all of the information and advisements contained in this prospectus, including the following risk factors and uncertainties.

RISKS RELATING TO OUR BUSINESS

WE HAVE A LIMITED OPERATING HISTORY WITH SIGNIFICANT LOSSES AND EXPECT LOSSES TO CONTINUE FOR THE FORESEEABLE FUTURE.

We have yet to establish any history of profitable operations. We have not had any significant revenues from our principal operations. We have incurred annual operating losses of $2,094,939, $2,183,377 and $995,549, respectively, during the past three fiscal years of operation and an operating loss of $1,504,427 in the nine months ended December 31, 2006. At March 31, 2006, we had an accumulated deficit of $22,062,447. We have incurred net losses from continuing operations of $2,920,183 and $2,096,951 for the fiscal years ending March 31, 2006 and 2005 and $1,787,569 and $2,069,698 for the nine months ended December 31, 2006 and 2005. As a result, at December 31, 2006, we had an accumulated deficit of $23,850,016. Our revenues have not been sufficient to sustain our operations. We expect that our revenues will not be sufficient to sustain our operations for the foreseeable future. Our profitability will require the successful commercialization of our Hemopurifier(R) technology. No assurances can be given when or if this will occur or that we will ever generate revenues or be profitable.

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

Our independent auditors noted in their report accompanying our financial statements for our fiscal year ended March 31, 2006 that we had a significant deficit accumulated during the development stage, had a working capital deficit and that a significant amount of additional capital will be necessary to advance the development of our products to the point at which we may become commercially viable and stated that those conditions raised substantial doubt about our ability to continue as a going concern. Note 1 to our financial statements addressed management's plans to address these matters. We cannot assure you that our business plans will be successful in addressing these issues. This opinion about our ability to continue as a going concern could affect our ability to obtain additional financing at favorable terms, if at all, as such an opinion may cause investors to lose faith in our long term prospects. If we cannot successfully continue as a going concern, our shareholders may lose their entire investment in our common shares.

WE WILL REQUIRE ADDITIONAL FINANCING TO SUSTAIN OUR OPERATIONS AND WITHOUT IT WE WILL NOT BE ABLE TO CONTINUE OPERATIONS; OUR AGREEMENT WITH FUSION CAPITAL MAY NOT PROVIDE SUFFICIENT OPERATING CAPTIAL FOR US.

At March 31, 2006 and December 31, 2006, we had a working capital deficit of $1,920,663 and $2,867,894, respectively. The independent auditors' report for the year ended March 31, 2006, includes an explanatory paragraph stating that our recurring losses from operations and working capital deficiency raise substantial doubt about our ability to continue as a going concern. We had a net operating cash flow deficit of $1,284,359 for the nine months ended December 31, 2006, a net operating cash flow deficit of $1,584,281 for the year ended March 31, 2006 and a net operating cash flow deficit of $1,559,366 for the year ended March 31, 2005. Although we have entered into the common stock purchase agreement with Fusion Capital we will may not have sufficient financial resources to fund our operations or those of our subsidiaries. Therefore, we may need additional funds to continue these operations. If we are unable to obtain such funds on terms acceptable to us, we may be unable to continue our operations.

We only have the right to receive $32,000 every two business days under the agreement with Fusion Capital unless our stock price equals or exceeds $0.30, in which case we can sell greater amounts to Fusion Capital as the price of our common stock increases. Fusion Capital shall not have the right nor the obligation to purchase any shares of our common stock on any business day that the market price of our common stock is less than $0.25. Since we are registering 6,000,000 shares that we may sell to Fusion Capital pursuant to this prospectus not including the commitment shares or the 1,333,333 shares already purchased by Fusion Capital, the selling price of our common stock to Fusion Capital will have to average at least approximately $1.33 per share for us to receive the remaining proceeds of $8,000,000. Assuming a purchase price of $0.75 per share (the closing sale price of the common stock on March 27, 2007) and the purchase by Fusion Capital of the full 7,333,333 shares under the common stock purchase agreement, proceeds to us would only be $4,900,000 which includes the initial purchase of 1,333,333 shares for $400,000.

The extent to which we rely on Fusion Capital as a source of funding will depend on a number of factors including, the prevailing market price of our common stock and the extent to which we are able to secure working capital from other sources, such as through the sale of our products. Specifically, Fusion Capital shall not have the right nor the obligation to purchase any shares of our common stock on any business days that the market price of our common stock is less than $0.25. If obtaining sufficient financing from Fusion Capital were to prove unavailable or prohibitively dilutive and if we are unable to generate

cash from the sale of enough of our products, we will need to secure another source of funding in order to satisfy our working capital needs. Even if we are able to access the full $8,4000,000 under the common stock purchase agreement with Fusion Capital, we may still need additional capital to fully implement our business, operating and development plans. Should the financing we require to sustain our working capital needs be unavailable to us on reasonable terms when we require it, the consequences could be a material adverse effect on our business, operating results, financial condition and prospects.

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

The U.S. Government has undertaken commitments to help secure improved countermeasures against bioterrorism. To date, we have been unsuccessful in obtaining grant income. As a result, future attempts to obtain grant income from the Federal Government will be sought through direct communication to government health and military agencies, and may include unsolicited proposals to provide the Hemopurifier(R) as a treatment countermeasure.

At present, the Hemopurifier(R) has not been approved for use by any U.S. Government agency, nor have we received any contracts to purchase the Hemopurifier(R). Since inception, we have not generated revenues from the sale of any product based on our Hemopurifier(R) technology platform. The process of obtaining government contracts is lengthy with the uncertainty that we will be successful in obtaining announced grants or contracts for therapeutics as a medical device technology. Accordingly, we cannot be certain that we will be awarded any U.S. Government grants or contracts utilizing our Hemopurifier(R) platform technology.

IF THE U.S. GOVERNMENT FAILS TO PURCHASE SUFFICIENT QUANTITIES OF ANY FUTURE BIODEFENSE CANDIDATE UTILIZING OUR HEMOPURIFIER(R) 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(R) platform technology that are approved by the U.S. Food and Drug Administration (the "FDA"), but the U.S. Government does not place sufficient orders for these products, our future business will be harmed.

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

Our business plan to provide biodefense product 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(R) medical device candidates we are developing. Our commercial opportunities will be reduced or eliminated if our competitors develop and market products for any of the diseases we target that:

- 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(R) products, and obtain FDA and other regulatory approvals necessary for commercializing them, our products may not compete effectively with other successful products. Researchers are continually learning more about diseases, which may lead to new technologies for treatment. Our competitors may succeed in developing and marketing products that are either more effective than those that

we may develop, alone or with our collaborators, or that are marketed before any products we develop are marketed.

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

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

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

WE HAVE LIMITED MANUFACTURING EXPERIENCE.

To achieve the levels of production necessary to commercialize our Hemopurifier(R) products, we will need secure manufacturing agreements with contract manufacturers which comply with good manufacturing practices standards and other standards prescribed by various federal, state and local regulatory agencies in the U.S. and any other country of use.

We have limited experience manufacturing products for testing purposes and no experience manufacturing products for large scale commercial purposes. We will likely outsource the manufacture of our Hemopurifier(R) products to third parties operating FDA-certified facilities. To date, we have manufactured devices on a small scale for testing purposes. There can be no assurance that manufacturing and control problems will not arise as we attempt to commercialize our products or that such manufacturing can be completed in a timely manner or at a commercially reasonable cost. Any failure to address such problems could delay or prevent commercialization of our products and would have a material adverse effect on us.

OUR HEMOPURIFIER(R) TECHNOLOGY MAY BECOME OBSOLETE.

Our Hemopurifier(R) products may be made unmarketable by new scientific or technological developments where new treatment modalities are introduced that are more efficacious and/or more economical than our Hemopurifier(R) 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(R) cartridges and the infected plasma samples used in preclinical testing of the Hemopurifier(R). All other chemicals are fully inventoried and reported to the appropriate authorities, such as the fire department, who inspect the facility on a regular basis. We are subject to federal, state, local and foreign laws governing the use, manufacture, storage, handling and disposal of such materials. Although we believe that our safety procedures for the use, manufacture, storage, handling and disposal of such materials comply with the standards prescribed by federal, state, local and foreign regulations, we cannot completely eliminate the risk of accidental contamination or injury from these materials. We have had no incidents or problems involving hazardous chemicals or biological samples. In the event of such an accident, we could be held liable for significant damages or fines. We currently carry a limited amount of insurance to protect us from these damages. In addition, we may be required to incur significant costs to comply with regulatory requirements in the future.

WE ARE DEPENDENT FOR OUR SUCCESS ON A FEW KEY EXECUTIVE OFFICERS. OUR INABILITY TO RETAIN THOSE OFFICERS WOULD IMPEDE OUR BUSINESS PLAN AND GROWTH STRATEGIES, WHICH WOULD HAVE A NEGATIVE IMPACT ON OUR BUSINESS AND THE VALUE OF YOUR INVESTMENT.

Our success depends to a critical extent on the continued services of our Chief Executive Officer, James A. Joyce and our Chief Science Officer, Richard H. Tullis. Were we to lose one or more of these key executive officers, we would be forced to expend significant time and money in the pursuit of a replacement, which would result in both a delay in the implementation of our business plan and the diversion of limited working capital. The loss of Dr. Tullis would harm the clinical development of our products due to his unique experience with the Hemopurifier(R) technology. The loss of Dr. Tullis and/or Mr. Joyce would be detrimental to our growth as they possess unique knowledge of our business model and infectious disease which would be difficult to replace within the biotechnology field. We can give you no assurance that we can find satisfactory replacements for these key executive officers at all, or on terms that are not unduly expensive or burdensome to our company. Although Mr. Joyce and Mr. Tullis have signed employment agreements providing for their continued service to our company, these agreements will not preclude them from leaving our company. We do not currently carry key man life insurance policies on any of our key executive officers which would assist us in recouping our costs in the event of the loss of those officers.

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

We currently have an extremely small staff comprised of six full time employees consisting of our Chief Executive Officer, our President, our Chief Science Officer, our Chief Financial Officer, a research scientist, a research associate and other personnel employed on a contract basis. Although we believe that these employees, together with the consultants currently engaged by our company, will be able to handle most of our additional administrative, research and development and business development in the near term, we will nevertheless be required over the longer-term to hire highly skilled managerial, scientific and administrative personnel to fully implement our business plan and growth strategies. Due to the specialized scientific nature of our business, we are highly dependent upon our ability to attract and retain qualified scientific, technical and managerial personal. Competition for these individuals, especially in San Diego where many biotechnology companies are located, is intense and we may not be able to attract, assimilate or retain additional highly qualified

personnel in the future. We cannot assure you that we will be able to engage the services of such qualified personnel at competitive prices or at all, particularly given the risks of employment attributable to our limited financial resources and lack of an established track record.

WE PLAN TO GROW 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 carry limited directors and officers liability insurance. Directors and officers liability insurance has recently become much more expensive and difficult to obtain. If we are unable to continue or provide directors and officers liability insurance at affordable rates or at all, it may become increasingly more difficult to attract and retain qualified outside directors to serve on our board of directors. We may lose potential independent board members and management candidates to other companies in the biotechnology field that have greater directors and officers liability insurance to insure them from liability or to biotechnology companies that have revenues or have received greater funding to date which can offer greater compensation packages. The fees of directors are also rising in response to their increased duties, obligations and liabilities as well as increased exposure to such risks. As a company with a limited operating history and limited resources, we will have a

more difficult time attracting and retaining management and outside independent directors than a more established company due to these enhanced duties, obligations and liabilities.

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

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

In the case of patents, we cannot give you any assurance that our existing patents will not be invalidated, that any patents that we currently or prospectively apply for will be granted, or that any of these patents will ultimately provide significant commercial benefits. Further, competing companies may circumvent any patents that we may hold by developing products which closely emulate but do not infringe our patents. While we intend to seek patent protection for our products in selected foreign countries, those patents may not receive the same degree of protection as they would in the United States. We can give you no assurance that we will be able to successfully defend our patents and proprietary rights in any action we may file for patent infringement. Similarly, we cannot give you any assurance that we will not be required to defend against litigation involving the patents or proprietary rights of others, or that we will be able to obtain licenses for these rights. Legal and accounting costs relating to prosecuting or defending patent infringement litigation may be substantial. We believe that certain patent applications filed and/or other patents issued more recently will help to protect the proprietary nature of the Hemopurifier(R) treatment technology.

The Hemopurifier(R) is protected by four issued patents, three of which we own and one in which we own an exclusive license. Three additional patent applications deal with treatments for virus infection and cancer treatment, one of which we own and two of which we own exclusive licenses.

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.

IF WE FAIL TO COMPLY WITH EXTENSIVE REGULATIONS OF DOMESTIC AND FOREIGN REGULATORY AUTHORITIES, THE COMMERCIALIZATION OF OUR PRODUCT CANDIDATES COULD BE PREVENTED OR DELAYED.

Our pathogen filtration devices, or Hemopurifier(R) products, are subject to extensive government regulations related to development, testing, manufacturing and commercialization in the U.S. 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 U.S. government through consultation with a number of governmental agencies, including the FDA, the National Institutes of

Health, the Centers for Disease Control and Prevention and the Department of Homeland Security. Our product candidates are in the pre-clinical and clinical stages of development and have not received required regulatory approval from the FDA to be commercially marketed and sold. The process of obtaining and complying with FDA and other governmental regulatory approvals and regulations is costly, time consuming, uncertain and subject to unanticipated delays. Such regulatory approval (if any) and product development requires several years. Despite the time and expense exerted, regulatory approval is never guaranteed. We also are subject to the following risks and obligations, among others.

- 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(R) 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(R) 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 medical device 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(R) product candidates do not prove to be safe or effective or do not receive required regulatory approvals, our financial results and the commercial prospects for our product candidates will be harmed. Furthermore, our inability to complete our clinical trials in a timely manner could jeopardize our ability to obtain regulatory approval.

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

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

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

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

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

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

Our previously planned products have not become marketable products due

in part to our transition in 2001 from a focus on utilizing our Hemopurifier(R) technology on treating harmful metals to treating infectious diseases prior to our having completed the FDA approval process. Our transition was made in order to focus on larger markets with an urgent need for new treatment and to take advantage of the greater sense of urgency surrounding acute and chronic infectious diseases. Prior to initiating the development of infectious disease Hemopurifiers(R), we successfully completed an FDA approved Phase I human safety trial of a Hemopurifier(R) to treat aluminum and iron intoxication. Since changing the focus to infectious disease research, we have not initiated an FDA approved human clinical trial as the development of the technology is still continuing and will require both significant capital and scientific resources. Our pending products face similar challenges of obtaining successful clinical trials in route to gaining FDA approval prior to commercialization. Additionally, our limited financial resources hinder the speed of our product development due to personnel constraints.

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.

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

The Hemopurifier(R) is protected by four issued patents, three of which we own and one which we have an exclusive license. Our exclusive license expires March 2020 and is subject to termination if the inventors have not received a minimum of $15,000 in any year during the term beginning in the second year after the Food & Drug Administration approves the Hemopurifier(R). These patents comprise a majority of our assets. At December 31, 2006, our intellectual property assets comprised 84.40% of our non-current assets, and 61.36% of all 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 the financial value of our patents is written down for accounting purposes 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 our general and administrative costs as we have incurred increased legal and accounting fees to comply with such rule changes. Further, proposed initiatives are expected to result in changes in certain accounting rules, including legislative and other proposals to account for employee stock options as a compensation expense. These and other potential changes could materially increase the expenses we report under accounting principles generally accepted

in the United States of America, and adversely affect our operating results.

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

Our Hemopurifier(R) products may be used in connection with medical procedures in which it is important that those products function with precision and accuracy. If our products do not function as designed, or are designed improperly, we may be forced by regulatory agencies to withdraw such products from the market. In addition, if medical personnel or their patients suffer injury as a result of any failure of our products to function as designed, or our products are designed inappropriately, we may be subject to lawsuits seeking significant compensatory and punitive damages. The risk of product liability claims, product recalls and associated adverse publicity is inherent in the

testing, manufacturing, marketing and sale of medical products. We do not have general clinical trial liability insurance coverage. There can be no assurance that future insurance coverage will to be adequate or available. We may not be able to secure product liability insurance coverage on acceptable terms or at reasonable costs when needed. Any product recall or lawsuit seeking significant monetary damages may have a material affect on our business and financial condition. Any liability for mandatory damages could exceed the amount of our coverage. Moreover, a product recall could generate substantial negative publicity about our products and business and inhibit or prevent commercialization of other future product candidates.

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 both in terms of how to approach bioterrorism and the amount of funding the government should provide for any programs involving homeland protection. Government funding for products on bioterrorism could be reduced which would hinder our ability to obtain governmental grants.

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.

THE SALE OF OUR COMMON STOCK TO FUSION CAPITAL MAY CAUSE DILUTION AND THE SALE OF THE SHARES OF COMMON STOCK ACQUIRED BY FUSION CAPITAL COULD CAUSE THE PRICE OF OUR COMMON STOCK TO DECLINE.

In connection with entering into the common stock purchase agreement, we authorized the issuance to Fusion Capital of up to 8,383,333 shares of our common stock, including 2,383,333 shares which have already been issued. The number of shares ultimately offered for sale by Fusion Capital under this prospectus is dependent upon the number of shares purchased by Fusion Capital under the agreement. The purchase price for the common stock to be sold to Fusion Capital pursuant to the common stock purchase agreement will fluctuate based on the price of our common stock. All 8,383,333 shares registered in this offering are

expected to be freely tradable. It is anticipated that shares registered in this offering will be sold over a period of up to 25 months from the date of this prospectus. Depending upon market liquidity at the time, a sale of shares under this offering at any given time could cause the trading price of our common stock to decline. Fusion Capital may ultimately purchase all, some or none of the remaining 6,000,000 shares of common stock not yet issued but registered in this offering. After it has acquired such shares, it may sell all, some or none of such shares. Therefore, sales to Fusion Capital by us under the agreement may result in substantial dilution to the interests of other holders of our common stock. The sale of a substantial number of shares of our common stock under this offering, or anticipation of such sales, could make it more difficult for us to sell equity or equity-related securities in the future at a time and at a price that we might otherwise wish to effect sales. However, we have the right to control the timing and amount of any sales of our shares to Fusion Capital and the agreement may be terminated by us at any time at our discretion without any cost to us.

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 March 30, 2007, our average trading volume per day for the past three months was approximately 211,049 shares a day with a high of 1,006,000 shares traded and a low of 33,200 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.

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 REVENUE 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 March 27, 2007, the high and low sale prices of a share of our common stock were $0.90 and $0.19, respectively. The volatility in our share price is attributable to a number of factors. First, as noted above, our common shares are sporadically and/or thinly traded. As a consequence of this lack of liquidity, the trading of relatively small quantities of shares by our shareholders may disproportionately influence the price of those shares in either direction. The price for our shares could, for example, decline precipitously in the event that a large number of our common shares are sold on the market without commensurate demand, as compared to a seasoned issuer which could better absorb those sales without adverse impact on its share price. Secondly, we are a speculative or "risky" investment due to our limited operating history and lack of revenue or profit to date, and the 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 a 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 BENEFICIALLY OWN OR CONTROL APPROXIMATELY 23.59% OF OUR OUTSTANDING COMMON SHARES AS OF March 27, 2007, WHICH MAY LIMIT THE ABILITY OF YOURSELF OR OTHER SHAREHOLDERS, WHETHER ACTING INDIVIDUALLY OR TOGETHER, TO PROPOSE OR DIRECT THE MANAGEMENT OR OVERALL DIRECTION OF OUR COMPANY. ADDITIONALLY, THIS CONCENTRATION OF OWNERSHIP COULD DISCOURAGE OR PREVENT A POTENTIAL TAKEOVER OF OUR COMPANY THAT MIGHT OTHERWISE RESULT IN YOU RECEIVING A PREMIUM OVER THE MARKET PRICE FOR YOUR COMMON SHARES.

As of March 27, 2007, our officers and directors beneficially own or control approximately 23.59% of our outstanding common shares (assuming the exercise of all outstanding options and warrants held by our officers and directors). These persons will have the ability to substantially influence 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 March 17, 2007, there are outstanding non-variable priced purchase options and warrants entitling the holders to purchase 20,054,309 common shares at a weighted average exercise price of $0.35 per share. There are 5,444,118 shares underlying promissory notes convertible into common stock at a weighted average exercise price of $0.20. The exercise price for all of the aforesaid warrants, may be less than your cost to acquire our common shares. In

the event of the exercise of these securities, you could suffer substantial dilution of your investment in terms of your percentage ownership in the company as well as the book value of your common shares. In addition, the holders of the common share purchase options or warrants may sell common shares in tandem with their exercise of those options or warrants to finance that exercise, or may resell the shares purchased in order to cover any income tax liabilities that may arise from their exercise of the options or warrants.

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

We are entitled under our certificate of incorporation to issue up to 100,000,000 shares of common stock. After taking into consideration our outstanding common stock at March 17, 2007, our convertible notes, outstanding options and outstanding warrants we will be entitled to issue up to 41,983,025 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 shares of common stock, or options or warrants to purchase those shares, under circumstances we may deem appropriate at the time.

OUR ISSUANCE OF ADDITIONAL COMMON SHARES IN EXCHANGE FOR SERVICES OR TO REPAY DEBT, WOULD DILUTE YOUR PROPORTIONATE OWNERSHIP AND VOTING RIGHTS AND COULD HAVE A NEGATIVE IMPACT ON THE MARKET PRICE OF OUR COMMON STOCK.

Our board may generally issue shares of common stock to pay for debt or services, without further approval by our shareholders based upon such factors as our board of directors may deem relevant at that time. For the past three years and for the nine months ended December 31, 2006, we issued a total of 2,728,578 shares for debt to reduce our obligations. The average price discount of common stock issued for debt in this period, weighted by the number of shares issued for debt in such period was 47.4%, 53.4% and 69.41% for the years ended 2004, 2005 and 2006. We issued 107,759 shares, at an average discount of 31.67% to market, for debt reduction for the nine months ended December 31, 2006. For the past three fiscal years we issued a total of 5,322,657 shares in payment for services. The average price discount of common stock issued for services during this period, weighted by the number of shares issued was 46.3%, 36.0% and 14.86% for the years ended 2004, 2005 and 2006, respectively. For the nine months ended December 31, 2006, we issued 561,566 shares for services valued at a premium to market of 4.85%. It is likely that we will issue additional securities to pay for services and reduce debt in the future. We cannot give you any assurance that we will not issue additional shares of common stock under circumstances we may deem appropriate at the time.

THE 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.

FORWARD-LOOKING STATEMENTS

This prospectus, including the sections titled "Prospectus Summary" and "Risk Factors" and other sections, contains certain statements that constitute "forward-looking statements".
These forward-looking statements are derived, in
part, from various assumptions and analyses we have made in the context of our current business plan and information currently available to us and in light of our experience and perceptions of historical trends, current conditions and expected future developments and other factors we believe to be appropriate in the circumstances. You can generally identify forward-looking statements through words and phrases such as "SEEK", "ANTICIPATE", "BELIEVE", "ESTIMATE", "EXPECT", "INTEND", "PLAN", "BUDGET", "PROJECT", "MAY BE", "MAY CONTINUE", "MAY LIKELY RESULT", and similar expressions. When reading any forward looking statement you should remain mindful that all forward-looking statements are inherently uncertain as they are based on current expectations and assumptions concerning future events or future performance of our company, and that actual results or developments may vary substantially from those expected as expressed in or implied by that statement for a number of reasons or factors, including those relating to:

- whether or not markets for our products develop and, if they do develop, the pace at which they develop;
- our ability to attract and retain the qualified personnel to implement our growth strategies,
- our ability to obtain approval from the Food and Drug Administration for our products;
- our ability to protect the patents on our proprietary technology;
- our ability to fund our short-term and long-term financing

needs;

- changes in our business plan and corporate strategies; and

- other risks and uncertainties discussed in greater detail in the sections of this prospectus, including those captioned "RISK FACTORS" and "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS".

Each forward-looking statement should be read in context with, and with an understanding of, the various other disclosures concerning our company and our business made elsewhere in this prospectus as well as other pubic reports filed with the United States Securities and Exchange Commission (the "SEC"). You should not place undue reliance on any forward-looking statement as a prediction of actual results or developments. We are not obligated to update or revise any forward-looking statement contained in this prospectus to reflect new events or circumstances unless and to the extent required by applicable law.

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by the selling shareholder. We will receive no proceeds from the sale of shares of common stock in this offering. However, we may receive up to $8.4 Million in proceeds from the sale of our common stock to Fusion Capital under the common stock purchase agreement. Any proceeds from Fusion Capital we receive under the common stock purchase agreement will be used for working capital and general corporate purposes.

THE FUSION TRANSACTION

General

On March 21, 2007, we entered into a common stock purchase agreement with Fusion Capital Fund II, LLC, an Illinois limited liability company. Under the agreement, Fusion Capital is obligated, under certain conditions, to purchase shares from us in an aggregate amount of $8.4 million from time to time over a 25 month period. Under the agreement, we have sold to Fusion Capital 1,333,333 shares of our common stock for total proceeds to us of $400,000. Fusion Capital has received a commitment fee consisting of 1,050,000 shares of our common stock. We have reserved up to an additional 6,000,000 shares of our common stock for sale to Fusion Capital under the agreement. As of March 27, 2007, there were 32,518,548 shares outstanding (27,587,195 shares held by non-affiliates) excluding the 6,000,000 shares offered by Fusion Capital pursuant to this prospectus which it has not yet purchased from us. If all of such 8,383,333 shares offered hereby were issued and outstanding as of the date hereof, the 8,383,333 shares would represent approximately 21.8% of the total common stock outstanding or approximately 24.96% of the non-affiliate shares outstanding as of March 27, 2007. The number of shares ultimately offered for sale by Fusion Capital is dependent upon the number of shares purchased by Fusion Capital under the agreement.

We do not have the right to commence any additional sales of our shares to Fusion Capital under the agreement until the Securities & Exchange Commission has declared effective the registration statement of which this prospectus is a part of. After the Securities & Exchange Commission has declared effective such registration statement, generally we have the right but not the obligation from time to time to sell our shares to Fusion Capital in amounts between $32,000 and

$1.0 million depending on certain conditions. We have the right to control the timing and amount of any sales of our shares to Fusion Capital. The purchase price of the shares will be determined based upon the market price of our shares without any fixed discount at the time of each sale. Fusion Capital shall not have the right or the obligation to purchase any shares of our common stock on any business day that the price of our common stock is below $0.25. The agreement may be terminated by us at any time at our discretion without any cost to us.

Purchase Of Shares Under The Common Stock Purchase Agreement

Under the common stock purchase agreement, on any business day selected by us, we may direct Fusion Capital to purchase up to $32,000 of our common stock. The purchase price per share is equal to the lesser of:

- the lowest sale price of our common stock on the purchase date; or
- the average of the three (3) lowest closing sale prices of our common stock during the twelve (12) consecutive business days prior to the date of a purchase by Fusion Capital.

The purchase price will be equitably adjusted for any reorganization, recapitalization, non-cash dividend, stock split, or other similar transaction occurring during the business days used to compute the purchase price. We may direct Fusion Capital to make multiple purchases from time to time in our sole discretion; no sooner then every two (2) business days.

Our Right To Increase the Amount to be Purchased

In addition to purchases of up to $32,000 from time to time, we may also from time to time elect on any single business day selected by us to require Fusion Capital to purchase our shares in an amount up to $50,000 provided that our share price is not below $0.30 during the three (3) business days prior to and on the purchase date. We may increase this amount to up to $100,000 if our share price is not below $0.40 during the three (3) business days prior to and on the purchase date. This amount may also be increased to up to $200,000 if our share price is not below $0.55 during the three (3) business days prior to and on the purchase date. This amount may also be increased to up

to $400,000 if our share price is not below $0.70 during the three (3) business days prior to and on the purchase date. This amount may also be increased to up to $1.0 million if our share price is not below $1.50 during the three (3) business days prior to and on the purchase date. We may direct Fusion Capital to make multiple large purchases from time to time in our sole discretion; however, at least two (2) business days must have passed since the most recent large purchase was completed. The price at which our common stock would be purchased in this type of larger purchase will be the lesser of (i) the lowest sale price of our common stock on the purchase date and (ii) the lowest purchase price (as described above) during the previous seven (7) business days prior to the purchase date.

Minimum Purchase Price

Under the common stock purchase agreement, we have set a minimum purchase price ("floor price") of $0.25. However, Fusion Capital shall not have the right or the obligation to purchase any shares of our common stock in the event that the purchase price would be less than the floor price. Specifically,

Fusion Capital shall not have the right or the obligation to purchase shares of our common stock on any business day that the market price of our common stock is below $0.25.

Events of Default

Generally, Fusion Capital may terminate the common stock purchase agreement without any liability or payment to the Company upon the occurrence of any of the following events of default:

- the effectiveness of the registration statement of which this prospectus is a part lapses for any reason (including, without limitation, the issuance of a stop order) or is unavailable to Fusion Capital for sale of our common stock offered hereby and such lapse or unavailability continues for a period of ten (10) consecutive business days or for more than an aggregate of thirty (30) business days in any 365-day period;

- suspension by our principal market of our common stock from trading for a period of three (3) consecutive business days;

- the de-listing of our common stock from our principal market provided our common stock is not immediately thereafter trading on the Nasdaq Global Market, the Nasdaq Capital Market, the New York Stock Exchange or the American Stock Exchange;

- the transfer agent`s failure for five (5) business days to issue to Fusion Capital shares of our common stock which Fusion Capital has purchased under the common stock purchase agreement;

- any material breach of the representations or warranties or covenants contained in the common stock purchase agreement or any related agreements which has or which could have a material adverse effect on us subject to a cure period of five (5) business days; or

- any participation or threatened participation in insolvency or bankruptcy proceedings by or against us.

Our Termination Rights

We have the unconditional right at any time for any reason to give notice to Fusion Capital terminating the common stock purchase agreement without any cost to us.

No Short-Selling or Hedging by Fusion Capital

Fusion Capital has agreed that neither it nor any of its affiliates shall engage in any direct or indirect short-selling or hedging of our common stock during any time prior to the termination of the common stock purchase agreement.

Commitment Shares Issued to Fusion Capital

Under the terms of the common stock purchase agreement, Fusion Capital

has received a commitment fee consisting of 1,050,000 shares of our common stock. Generally, unless an event of default occurs, Fusion Capital must own at least 1,050,000 shares of our common stock until 25 months from the date of the agreement or until the agreement is terminated.

Effect of Performance of the Common Stock Purchase Agreement on Our Stockholders

All 8,383,333 shares registered in this offering are expected to be freely tradable. It is anticipated that shares registered in this offering will be sold over a period of up to 25 months from the date of this prospectus. The sale by Fusion Capital of a significant amount of shares registered in this offering at any given time could cause the market price of our common stock to decline and to be highly volatile. Fusion Capital may ultimately purchase all, some or none of the 6,000,000 shares of common stock not yet issued but registered in this offering. After it has acquired such shares, it may sell all, some or none of such shares. Therefore, sales to Fusion Capital by us under the agreement may result in substantial dilution to the interests of other holders of our common stock. However, we have the right to control the timing and amount of any sales of our shares to Fusion Capital and the agreement may be terminated by us at any time at our discretion without any cost to us.

In connection with entering into the agreement, we authorized the sale to Fusion Capital of up to 6,000,000 shares of our common stock. The number of shares ultimately offered for sale by Fusion Capital under this prospectus is dependent upon the number of shares purchased by Fusion Capital under the agreement. The following table sets forth the amount of proceeds we would receive from Fusion Capital from the sale of shares at varying purchase prices in addition to the $400,000 we have already received:

Assumed Average Purchase Price	Number of Shares to be Issued if Full Purchase	Percentage of Outstanding Shares After Giving Effect to the Issuance to Fusion Capital(1)	Proceeds from the Sale Shares to Fusion Capit Under the Common Stock Purchase Agreement
$0.25	6,000,000	15.58%	$ 1,500,000
$0.35	6,000,000	15.58%	$ 2,100,000
$0.50	6,000,000	15.58%	$ 3,000,000
$0.75(2)	6,000,000	15.58%	$ 4,500,000
$1.00	6,000,000	15.58%	$ 6,000,000
$1.33	6,000,000	15.58%	$ 7,980,000

(1) Based on 32,518,548 shares outstanding as of March 27, 2007. Includes the 2,383,333 shares already acquired by Fusion Capital under the agreement and the number of shares issuable under the agreement at the corresponding assumed purchase price set forth in the adjacent column.

(2) Closing sale price of our shares on March 27, 2007.

DESCRIPTION OF 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.

On January 10, 2000, we acquired all the outstanding common stock of Syngen Research, Inc. ("Syngen") in exchange for 65,000 shares of our restricted 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 Science 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, management 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 developmental stage medical device company focused on expanding the applications of our Hemopurifier (R) platform technology which is designed to rapidly reduce the presence of infectious viruses and other toxins from human blood. As such, we focus on developing therapeutic devices to treat acute viral conditions brought on by pathogens targeted as potential biological warfare agents and chronic viral conditions including HIV/AIDS and Hepatitis-C. The Hemopurifier (R) combines the established scientific technologies of hemodialysis and affinity chromatography as a means to mimic the immune system's response of clearing viruses and toxins from the blood before cell and organ infection can occur. The Hemopurifier (R) cannot cure these afflictions but can lower viral loads and allow compromised immune systems to overcome otherwise serious or fatal medical conditions.

The Hemopurifier(R)

The Hemopurifier(R) is an broad spectrum platform technology that combines the established scientific methods of hemodialysis (artificial kidneys) and affinity chromatography (a method that allows the selective capture of viruses and related toxins) as a means to augment the natural immune response of clearing infectious virus and toxins from the blood. The therapeutic goal of each Hemopurifier (R) application is to improve patient survival rates by reducing viral load and preserving the immune function. We believe that the Hemopurifier (R) will enhance and prolong the benefit of current infectious disease drug therapies and fill the void for patients who inevitably become resistant to such therapies. The Hemopurifier (R) is also positioned to treat those infected by biological agents for which there are no effective drug or vaccine treatments. The Hemopurifier (R) is not a substitute for antiviral drug or vaccine therapies, as it is solely positioned to treat drug and vaccine resistant pathogens.

Traditionally, hemodialysis (kidney dialysis) has been used to remove urea and other small metabolic toxins that accumulate in the blood of people with acute or chronic kidney failure (also called renal failure). Acute renal failure is generally treated in hospital intensive care units using a continuous filtration therapy. Chronic renal failure is treated through intermittent, thrice-weekly kidney dialysis in a specialized clinic setting. A catheter is most often the method used to gain access to the blood which is then pumped through thousands of hollow micro-fibers running the length of the kidney dialysis cartridge. Within the cartridge, toxins, urea and excess water pass through small pores in the walls of the micro-fibers and are removed by a separately circulating dialysis fluid outside of the fibers. Blood cells and molecules that are too large to pass through the pores are retained and the cleansed blood is returned back to circulation.

The Hemopurifier (R) modifies this process in several ways to provide an efficient method to selectively remove targeted viruses and toxins. First, the pores of the micro-fibers within the Hemopurifier (R) are large enough to allow circulating infectious viruses and toxins to separate from the blood and diffuse through the walls of the fibers. Second, within the cartridge but outside of the fibers the Hemopurifier (R) contains a unique material (the "affinity agent") which selectively binds to the viruses or toxins. Because of the affinity agent's ability to bind to viruses and toxins, there is no need for a separate circulation of a dialysis solution within the Hemopurifier (R). This provides the flexibility to use the Hemopurifier (R) either on kidney dialysis machines (global infrastructure), by employing a simple pump mechanism or by using a patient's own blood pressure (in field or military applications)to drive circulation.

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) 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(R) technology represents a new approach to treating viral diseases. The application 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 the Hemopurifier(R) cartridge prevents virus and toxins from infecting tissues and cells. The device cannot cure HIV and Hepatitis-C but appears to augment the immune response of clearing viruses and toxins from the blood before infection can occur. Scientifically, this action is known as "Fusion Inhibition" since the ability of the virus to enter or fuse with host cells or organs is inhibited.

The Hemopurifier(R) is positioned as a therapeutic medical device that can be quickly deployed to treat genetically engineered and drug and vaccine resistant biowarfare agents. For example, we demonstrated the ability to rapidly build and test new antibody cartridges upon receipt of an antibody against HIV which was previously untested for its utility as an agent to be immobilized within the Hemopurifier(R) treatment cartridge. The process included the attachment of the antibody to agarose beads to create an affinity or binding solution that was immobilized within the hollow-fiber treatment cartridge as means to capture HIV as it diffused through the fibers. Human blood infected with HIV was then circulated through the cartridge to measure the ability of the Hemopurifier(R) to capture HIV over a range of time periods. Human blood infected with HIV was also circulated through a control cartridge without immobilized antibodies as a means to document an improved ability to capture infectious virus when the immobilized antibody was utilized in the treatment cartridge. Upon completion of the circulation of infected blood, diagnostic studies were conducted to verify the viral capture rate of the Hemopurifier(R) with and without the immobilized antibody. The data was then provided in a confidential report to the antibody manufacturer within ten days of the original receipt of the antibody in our labs.

Biological Weapons

We are developing treatments to combat infectious agents that may be used in biological warfare and terrorism. We are working to design Hemopurifiers(R) 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 bioterrorism threats. These agents include the viruses that cause Smallpox, hemorrhagic fevers such as Ebola and Marburg, the Anthrax toxin, and Botulinum toxin. We have not yet published any data related to the treatment of any "Category A" agent. In March 2007, we submitted an Investigational Device Exemption ("IDE") with the FDA the goal of which is to obtain approval to conduct human safety and, if applicable, animal efficacy trials targeted to a specific bioterror viral agent. We are presently in the process of conducting in-vitro trials to determine the most appropriate "Category A" application.

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(R) to treat pathogens that are bioweapons candidates will be sold directly to the U.S. military and the federal government. Sale of Hemopurifiers(R) to treat chronic viral conditions will be directed through organizations with established distribution channels.

Research and Development

In fiscal year 2001, we realigned our research and development activities from developing Hemopurifiers(R) to treat harmful metals to developing Hemopurifiers(R) for the treatment of chronic viral conditions. 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 year 2001. This consolidation was completed during the first quarter of fiscal year 2002 and our facilities in Buffalo, N.Y. were closed. In 2004, we expanded our research effort to include the development of Hemopurifiers(R) to treat acute viral diseases as well as countermeasures against biological weapons. The cost of research and development, all of which has been charged to operations, amounted to approximately $1,251,000 over the last two fiscal years.

Patents

We currently own or have license rights to a number of U.S. and foreign patents and patent applications and endeavor to continually improve our intellectual property position. We consider the protection of our technology, whether owned or licensed, to the exclusion of use by others, to be vital to our business. While we intend to focus primarily on patented or patentable technology, we may also rely on trade secrets, unpatented property, know-how, regulatory exclusivity, patent extensions and continuing technological innovation to develop our competitive position.

In certain countries, medical devices are not patentable or only recently have become patentable, and enforcement of intellectual property rights in some countries has been limited or non-existent. Future enforcement of patents and proprietary rights in many countries can be expected to be problematic or unpredictable. We cannot guarantee that any patents issued or licensed to us will provide us with competitive advantages or will not be challenged by others. Furthermore, we cannot be certain that others will not independently develop similar products or will not design around patents issued or licensed to us. We cannot guarantee that patents that are issued will not be challenged, invalidated or infringed upon or designed around by others, or that the claims contained in such patents will not infringe the patent claims of others, or provide us with significant protection against competitive products, or otherwise be commercially valuable. We may need to acquire licenses under patents belonging to others for technology potentially useful or necessary to us. If any such licenses are required, we cannot be certain that they will be available on terms acceptable to us, if at all. To the extent that we are unable to obtain patent protection for our products or technology, our business may be materially adversely affected by competitors who develop substantially equivalent technology.

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 very 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 chronic and acute viral diseases 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 generally toxic, are expensive to develop, and inevitably infected patients will develop viral strains that become resistant to drug treatment. As a result, patients are ultimately left without

treatment options.

COMPETITION

We are advancing our Hemopurifier(R) technology as a treatment to enhance and prolong current drug therapies by removing the viral strains that cause drug resistance. The Hemopurifier(R) 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(R) competes with the current drug therapy treatment standard. However, if the industry considered the Hemopurifier(R) to be a potential replacement for drug therapy, then the marketplace for the Hemopurifier(R) would be extremely competitive. We are also pursuing the development of Hemopurifiers(R) to be utilized as treatment countermeasures against biological weapons. In this regard, we are targeting the treatment of pathogens, which are microbial organisms that cause disease, in which current treatments are either limited or do not exist. We believe that we are the sole developer of viral filtration systems (Hemopurifiers(R)) to treat chronic viral conditions, acute viral conditions and biological weapons. However, we face competition from the producers of the following alternative treatment options for all market applications.

Antiviral Drugs

For viral infections, specific antiviral drugs can be effective, but there are none that are effective against a broad-spectrum of infectious virus. At present, only a few antiviral drugs are available to treat the multitude of viruses that could be used as biological weapons. For example, Ribavirin is the treatment of choice for certain viral hemorrhagic fever infections, but has no current application to Ebola and Marburg infections. Newer antiviral drugs have shown some promise in animal models, and limited case reports in humans are encouraging. The lack of broad-spectrum antivirals takes on added significance in light of the ability of many viruses to rapidly develop resistance.

Current efforts to define the genetic details of normal and pathogenic agents on a molecular level promise the hope of new points of attack. Genomic analysis of viral pathogens and animal models of responses to infection provide valuable information enabling the potential development of novel treatment and prevention strategies. However, even the rapid elucidation of the genetic structure of a specific pathogen does not provide sufficient information to quickly design an effective cure.

Another approach in drug development is combinatorial chemistry, which provides the ability to rapidly synthesize large libraries of related compounds, many of which are completely new. However, there is still a need to laboriously screen each new compound for efficacy in fighting a particular disease. In that sense, combinatorial drugs confront the same problem as the traditional method of screening of plant and animal extracts for active compounds that block viral or bacterial replication.

Vaccines

Historically, the most effective tools in controlling infections have been vaccines. Polio, measles, mumps and many other viral illnesses are now controllable and smallpox has been eradicated from nature. Licensed vaccines for hemorrhagic fever viruses are limited to yellow fever (though others are in the trial phase of approval). Promising vaccines are being tested for some of the other diseases, but research is hampered by the need to conduct the studies in secure laboratories.

There are other problems with relying on vaccines as our primary protection against a biological weapons attack. While vaccination may be an effective treatment in a military setting, it would be problematic for civilian

populations for several reasons:

- The infectious virus would have to be known prior to vaccine deployment. With the exception of smallpox, post-exposure vaccination is ineffective.
- If everyone in the United States could be vaccinated, it would be impossible to vaccinate people against every viral threat.
- Vaccines are only useful if the viral target has not mutated o or been genetically altered.

Vaccines that are effective and safe are difficult to develop. History has shown that such development can be a slow process and may not even be possible for highly mutable pathogens like HIV and Hepatitis C. Moreover, current vaccine strategies often carry significant risk for complications. For example, the smallpox vaccine, which uses attenuated strains of a live virus, can occasionally cause illness or death by infection from the very organism that usually provides protection.

GOVERNMENT REGULATION

The Hemopurifier(R) is a medical device subject to extensive and rigorous regulation by FDA, as well as other federal and state regulatory bodies in the United States and comparable authorities in other countries. Therefore, we cannot assure that our technology will successfully complete any regulatory clinical trial for any of our proposed applications.

One of the problems facing the FDA is the need to ensure public safety while at the same time preventing unsafe treatments from reaching the public. The balance between these competing pressures has resulted in a long and deliberate process for approving new treatments, which is not responsive to the urgent need for new treatments presented in the era of bioterrorism. For most drugs, the principal research and development phases take several years prior to a drug being submitted to the FDA for testing. A clinical research program takes two to ten years, depending on the agent and clinical indication, after which the marketing application review period requires an average of one year. Once a product is approved for market, long-term post-marketing surveillance, inspections, and product testing must be performed to ensure the quality, safety, and efficacy of the product, as well as appropriate product labeling.

FDA'S PREMARKET CLEARANCE AND APPROVAL REQUIREMENTS. Each medical device we wish to commercialize in the United States will require the filing of a Premarket Approval ("PMA") from FDA. Medical devices are classified into one of three classes--Class I, Class II, or Class III--depending on the degree or risk associated with each medical device and the extent of control needed to ensure safety and effectiveness. Devices deemed to pose lower risks are placed in either Class I or II, which requires the manufacturer to submit to FDA a premarket notification requesting permission to commercially distribute the device. Our Hemopurifier(R) has been categorized as a Class III device, requiring premarket approval.

CLINICAL TRIALS. Clinical trials are almost always required to support an FDA premarket application. In the United States, these trials generally require submission of an application for an Investigational Device Exemption, or IDE, to FDA. The IDE application must be supported by appropriate data, such as animal and laboratory testing results, showing that it is safe to test the device in humans and that the testing protocol is scientifically sound. The IDE

must be approved in advance by FDA for a specific number of patients unless the product is deemed a non-significant risk device eligible for more abbreviated IDE requirements. Clinical trials for significant risk devices may not begin until the IDE application is approved by FDA and the appropriate institutional review boards, or IRBs, at the clinical trial sites. Our clinical trials must be conducted under the oversight of an IRB at the relevant clinical trial sites and in accordance with FDA regulations, including but not limited to those relating to good clinical practices. We are also required to obtain patients' informed consent that complies with both FDA requirements and state and federal privacy regulations. We, FDA or the IRB at each site at which a clinical trial is being performed may suspend a clinical trial at any time for various reasons, including a belief that the risks to study subjects outweigh the benefits. Even if a trial is completed, the results of clinical testing may not demonstrate the safety and efficacy of the device, may not be equivocal or may otherwise not be sufficient to obtain approval of the product. Similarly, in Europe the clinical study must be approved by the local ethics committee and in some cases, including studies with high-risk devices, by the Ministry of Health in the applicable country.

In March 2007 we submitted an Investigational Device Exemption ("IDE") with the FDA the goal of which is to obtain approval to conduct human safety and, if applicable, animal efficacy trials targeted to a specific bioterror viral agent. We are presently in the process of conducting in-vitro trials to determine the most appropriate "Category A" bioterror application. Upon successful completion of the IDE clinical trials, we would anticipate submitting a PMA (see below).

PREMARKET APPROVAL PATHWAY. A PMA application must be supported by extensive data, including but not limited to technical, preclinical, clinical trials, manufacturing and labeling to demonstrate to FDA's satisfaction the safety and effectiveness of the device.

After a PMA application is submitted and FDA determines that the application is sufficiently complete to permit a substantive review, FDA will accept the application for review. FDA has 180 days to review an "accepted" PMA application, although the review of an application generally occurs over a significantly longer period of time and can take up to several years. During this review period, FDA may request additional information or clarification of the information already provided. Also, an advisory panel of experts from outside FDA may be convened to review and evaluate the application and provide recommendations to FDA as to the approvability of the device. In addition, FDA will conduct a pre-approval inspection of the manufacturing facility to ensure compliance with quality system regulations. New PMA applications or PMA application supplements are required for significant modification to the manufacturing process, labeling and design of a device that is approved through the premarket approval process. Premarket approval supplements often require submission of the same type of information as a premarket approval application, except that the supplement is limited to information needed to support any changes from the device covered by the original premarket approval application and may not require as extensive clinical data or the convening of an advisory panel.

PERVASIVE AND CONTINUING REGULATION. After a device is placed on the market, numerous regulatory requirements continue to apply. These include:

- FDA's Quality System Regulation, or QSR, which requires manufacturers, including third-party manufacturers, to follow stringent design, testing, control, documentation and other quality assurance procedures during all aspects of the

manufacturing process;

- labeling regulations and FDA prohibitions against the promotion of products for uncleared, unapproved or off-label uses;
- clearance or approval of product modifications that could significantly affect safety or efficacy or that would constitute a major change in intended use;
- medical device reporting, or MDR, regulations, which require that manufacturers report to FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur; and
- post-market surveillance regulations, which apply when necessary to protect the public health or to provide additional safety and effectiveness data for the device.

After a device receives a PMA, any modification that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, will require a new clearance or approval. FDA requires each manufacturer to make this determination initially, but FDA can review any such decision and can disagree with a manufacturer's determination.

The regulations also require that we report to FDA any incident in which our product may have caused or contributed to a death or serious injury or in which our product malfunctioned and, if the malfunction were to recur, would likely cause or contribute to death or serious injury.

FRAUD AND ABUSE. We may also directly or indirectly be subject to various federal and state laws pertaining to healthcare fraud and abuse, including anti-kickback laws. In particular, the federal healthcare program Anti-Kickback Statute prohibits persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual, or the furnishing, arranging for or recommending a good or service, for which payment may be made in whole or part under federal healthcare programs, such as the Medicare and Medicaid programs. Penalties for violations include criminal penalties and civil sanctions such as fines, imprisonment and possible exclusion from Medicare, Medicaid and other federal healthcare programs. The Anti-Kickback Statute is broad and prohibits many arrangements and practices that are lawful in businesses outside of the healthcare industry. In implementing the statute, the Office of Inspector General, or OIG, has issued a series of regulations, known as the "safe harbors." These safe harbors set forth provisions that, if all their applicable requirements are met, will assure healthcare providers and other parties that they will not be prosecuted under the Anti-Kickback Statute. The failure of a transaction or arrangement to fit precisely within one or more safe harbors does not necessarily mean that it is illegal or that prosecution will be pursued. However, conduct and business arrangements that do not fully satisfy each applicable element of a safe harbor may result in increased scrutiny by government enforcement authorities, such as the OIG.

INTERNATIONAL. International sales of medical devices are subject to foreign governmental regulations, which vary substantially from country to country. The time required to obtain clearance or approval by a foreign country

may be longer or shorter than that required for FDA clearance or approval, and the requirements may be different.

The primary regulatory environment in Europe is that of the European Union, which has adopted numerous directives and has promulgated voluntary standards regulating the design, manufacture, clinical trials, labeling and adverse event reporting for medical devices. Devices that comply with the requirements of a relevant directive will be entitled to bear CE conformity marking, indicating that the device conforms with the essential requirements of the applicable directives and, accordingly, can be commercially distributed throughout the member states of the European Union, and other countries that comply with or mirror these directives. The method of assessing conformity varies depending on the type and class of the product, but normally involves a combination of self-assessment by the manufacturer and a third-party assessment by a notified body, an independent and neutral institution appointed by a country to conduct the conformity assessment. This third-party assessment may consist of an audit of the manufacturer's quality system and specific testing of the manufacturer's device. Such an assessment is required in order for a manufacturer to commercially distribute the product throughout these countries. ISO 9001 and ISO 13845 certifications are voluntary harmonized standards. Compliance establishes the presumption of conformity with the essential requirements for a CE Marking.

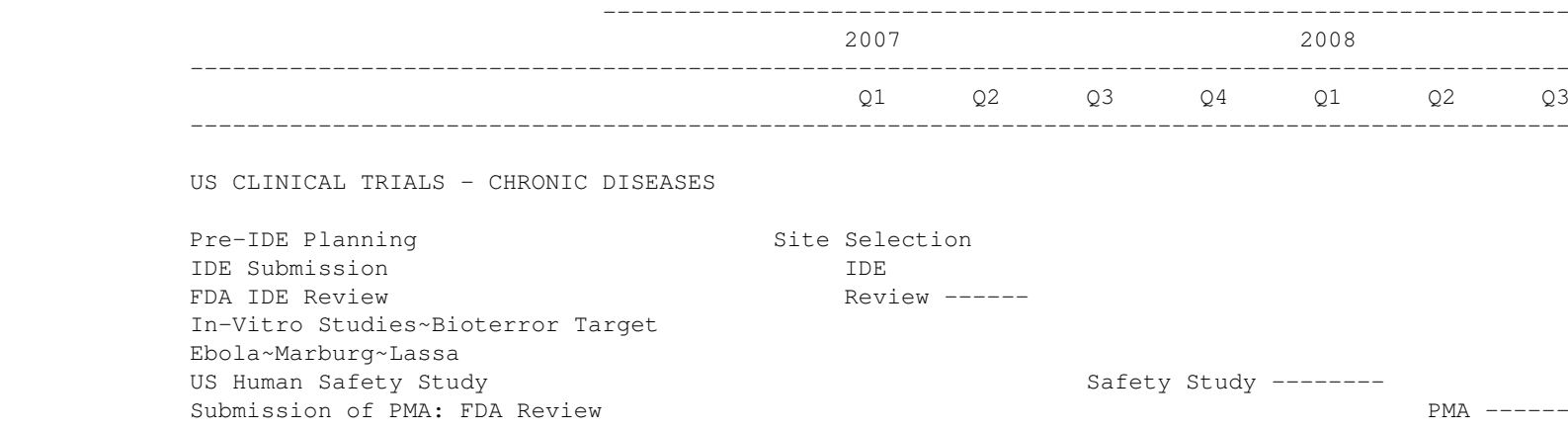
We have completed preclinical studies that demonstrate the removal of HIV and Hepatitis C virus from infected human blood. We have also completed initial animal safety studies, limited human safety studies and are presently engaged in the in-vitro testing and clinical planning required to support our IDE submission as outlined in the "Timelines" table below.

The outline and table below describe suggested timelines for the generation and testing of our current targets. The timelines presuppose the development of a working relationship with government or private agencies capable of handling biowarfare agents and refer to calendar year dates.

US CLINICAL TRIALS - IDE:

- Human safety study site selection - Q1 2007
- IDE filing and FDA review: Q1 - Q2 2007
- In-vitro studies at BSL4 Facility to determine appropriate bioweapon agent target (i.e. Ebola, Marburg, Lassa): Q1 - Q2 2007
- FDA approval of human safety study/protocol - Q2 2007
- Human Safety Study: Q3 2007 through Q1 2008
- PMA - Q2 2008

Note that the Hemopurifier(R) technology is applicable to a range of "Class A" Bio-weapons candidates and that the safety studies noted above begin the process of determining those which have the largest market potential or strategic importance. We have estimated the direct costs for performing the proposed submissions and clinical tests on the above timetable will require at least $4.1 million through the end of calendar 2008.



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 individual 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

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Operating income

8,266

5,590

Interest expense

(303

)

(362

)

Gain on sale of product line (Note 8)

5,706

Other (expense) income

(105

)

69

Income before income taxes

13,564

5,297

Income taxes

4,747

1,820

Net income

$

8,817

$

3,477

Net (gain) loss attributable to non-controlling interest

(42

)

63

Net income attributable to Chase Corporation

$

8,775

$

3,540

Net income available to common shareholders, per common and common equivalent share

Basic

$

0.96

$

0.39

Diluted

$

0.94

$

0.39

Weighted average shares outstanding

Basic

8,938,149

8,851,314	
Diluted	
9,149,677	
8,927,970	
Annual cash dividends declared per share	
$ 0.45	
$ 0.40	

See accompanying notes to the consolidated financial statements

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CHASE CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

Dollars in thousands

	Three Months Ended November 30,	
	2013	**2012**
Net income	$ 8,817	$ 3,477
Other comprehensive income:		
Net unrealized loss on restricted investments, net of tax	71	
Change in funded status of pension plans, net of tax	48	272
Foreign currency translation adjustment	1,578	404
Total other comprehensive income	1,697	676
Comprehensive income	10,514	4,153
Comprehensive (income) loss attributable to non-controlling interest	(42)	63
Comprehensive income attributable to Chase Corporation	$ 10,472	$ 4,216

See accompanying notes to the consolidated financial statements

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CHASE CORPORATION

CONSOLIDATED STATEMENT OF EQUITY

(UNAUDITED)

Dollars in thousands

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Chase Stockholders Equity	Non-conrolling Interest	Total Equity
Balance at August 31, 2013	9,066,115	$ 907	$ 13,336	$ (5,163)	$ 103,734	$ 112,814	$ 1,046	$ 113,860
Restricted stock grants, net of forfeitures	28,753	3	(3)					
Amortization of restricted stock grants			265			265		265
Amortization of stock option grants			64			64		64
Cash dividend accrued, $0.45 per share					(4,093)	(4,093)		(4,093)
Change in funded status of pension plan, net of tax of $26				48		48		48
Foreign currency translation adjustment				1,578		1,578		1,578
Net unrealized gain on restricted investments, net of tax of $38				71		71		71
Net income					8,775	8,775	42	8,817
Balance at November 30, 2013	9,094,868	$ 910	$ 13,662	$ (3,466)	$ 108,416	$ 119,522	$ 1,088	$ 120,610

See accompanying notes to the consolidated financial statements

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CHASE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

Dollars in thousands

	Three Months Ended November 30,	
	2013	**2012**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 8,817	$ 3,477
Adjustments to reconcile net income to net cash provided by operating activities		
Gain on sale of assets	(6)	(4)
Gain on sale of product line	(5,706)	
Depreciation	1,426	1,508
Amortization	1,194	1,217
Cost of sale of inventory step-up		564
Recovery on allowance for doubtful accounts	(38)	(130)
Stock based compensation	329	419
Realized gain on restricted investments	(5)	(25)
Decrease in cash surrender value life insurance	30	82
Pension curtailment and settlement loss		352
Increase (decrease) from changes in assets and liabilities		
Accounts receivable	1,619	839
Inventories	(4,032)	(4,818)
Prepaid expenses & other assets	(2,112)	(623)
Accounts payable	3,074	3,753
Accrued compensation and other expenses	(4,522)	(4,131)
Accrued income taxes	1,792	(399)
Deferred compensation	123	35
Net cash provided by operating activities	1,983	2,116
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(781)	(544)
Cost to acquire intangible assets	(22)	(101)
Contingent purchase price paid for acquisition		84
Proceeds from sale of fixed assets	11	11
Net proceeds from sale of product line	6,655	
Contributions from restricted investments	(21)	(22)
Payments for cash surrender value life insurance	(46)	(24)
Net cash provided by (used in) investing activities	5,796	(596)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments of principal on debt	(1,400)	(1,400)
Net cash used in financing activities	(1,400)	(1,400)
INCREASE IN CASH & CASH EQUIVALENTS	6,379	120
Effect of foreign exchange rates on cash	552	73
CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD	29,997	15,180

CASH & CASH EQUIVALENTS, END OF PERIOD	$	36,928	$	15,373
Non-cash Investing and Financing Activities				
Property, plant & equipment additions included in accounts payable	$	90	$	157
Annual cash dividend declared	$	4,093	$	3,626

See accompanying notes to the consolidated financial statements

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

Note 1 - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Therefore, they do not include all information and footnote disclosure necessary for a complete presentation of Chase Corporation s financial position, results of operations and cash flows, in conformity with generally accepted accounting principles. Chase Corporation (the Company, Chase, we, or us) filed audited consolidated financial statements, which included all information and notes necessary for such complete presentation for the three years ended August 31, 2013 in conjunction with its 2013 Annual Report on Form 10-K.

The results of operations for the interim period ended November 30, 2013 are not necessarily indicative of the results to be expected for any future period or the entire fiscal year. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended August 31, 2013, which are contained in the Company s 2013 Annual Report on Form 10-K.

The accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring items) which are, in the opinion of management, necessary for a fair statement of the Company s financial position as of November 30, 2013, the results of operations, comprehensive income and cash flows for the interim periods ended November 30, 2013 and 2012, and changes in equity for the interim period ended November 30, 2013.

The financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. The Company uses the U.S. dollar as the reporting currency for financial reporting. The financial position and results of operations of the Company s UK-based operations are measured using the British Pound as the functional currency and the financial position and results of operations of the Company s operations based in France are measured using the euro as the functional currency. Foreign currency translation gains and losses are determined using current exchange rates for monetary items and historical exchange rates for other balance sheet items and are recorded as a change in other comprehensive income. Translation gains and losses generated from the remeasurement of assets and liabilities denominated in currencies other than the functional currency of our foreign operations are included in other (expense) / income on the consolidated statements of operations.

During the third quarter of fiscal 2013, an immaterial error was identified in the presentation of two line items within the operating activities section of the Company s previously reported statement of cash flows for the comparing period ended November 30, 2012. The Company revised the statement of cash flows to correct the presentation of two line items within the operating activities section. This revision to the statement of cash flows results in pension curtailment and settlement loss changing from ($352) to $352 and accrued compensation and other expenses changing from ($3,427) to ($4,131) for the three months ended November 30, 2012. There was no impact on the comparing balance sheet or the related statement of operations, statement of comprehensive income, total cash provided by operating activities or overall cash

flows.

During the fourth quarter of fiscal 2013, the Company identified an immaterial error in the statement of comprehensive income within the Company s previously reported unaudited financial statements for the first three quarters of fiscal 2013. In those fiscal quarters, the Company properly recorded pension

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

settlement losses that resulted from lump sum distributions to pension plan participants in earnings, but did not properly reclassify the amount out of Equity Accumulated Other Comprehensive Income (Loss). As a result, the Company revised the reclassification adjustment for the change in funded status of pension plans line item from $58 to $272 for the three months ended November 30, 2012. There was no impact on the comparing balance sheet or the related statement of operations, and statement of cash flows.

The Company has evaluated events and transactions subsequent to the balance sheet date. Based on this evaluation, the Company is not aware of any events or transactions that occurred subsequent to the balance sheet date but prior to filing that would require recognition or disclosure in its consolidated financial statements.

Note 2 Recent Accounting Policies

Recently Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income . This ASU expands the presentation of changes in accumulated other comprehensive income. The new guidance requires an entity to disaggregate the total change of each component of other comprehensive income either on the face of the net income statement or as a separate disclosure in the notes. ASU 2013-02 is effective for fiscal years beginning after December 15, 2012. The Company adopted this ASU in the first quarter of fiscal 2014 (See Note 13 for additional details). The provisions of ASU 2013-02 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

Note 3 Inventories

Inventories consist of the following as of November 30, 2013 and August 31, 2013:

	November 30, 2013	August 31, 2013
Raw materials	$ 15,032	$ 14,545
Work in process	6,665	5,967

Finished goods		12,286		11,536
Total Inventories	$	33,983	$	32,048

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

Note 4 Net Income Per Share

The Company has unvested share-based payment awards with a right to receive nonforfeitable dividends which are considered participating securities under ASC Topic 260, Earnings Per Share . The Company allocates earnings to participating securities and computes earnings per share using the two class method. The determination of earnings per share under the two-class method is as follows:

	Three Months Ended November 30,	
	2013	2012
Basic Earnings per Share		
Net income attributable to Chase Corporation	$ 8,775	$ 3,540
Less: Allocated to participating securities	151	77
Net income available to common shareholders	$ 8,624	$ 3,463
Basic weighted average shares outstanding	8,938,149	8,851,314
Net income per share - Basic	$ 0.96	$ 0.39
Diluted Earnings per Share		
Net income attributable to Chase Corporation	$ 8,775	$ 3,540
Less: Allocated to participating securities	148	76
Net income available to common shareholders	$ 8,627	$ 3,464
Basic weighted average shares outstanding	8,938,149	8,851,314
Additional dilutive common stock equivalents	211,528	76,656
Diluted weighted average shares outstanding	9,149,677	8,927,970
Net income per share - Diluted	$ 0.94	$ 0.39

Included in the calculation of dilutive common stock equivalents are the unvested portion of restricted stock and stock options.

Note 5 Stock Based Compensation

In October 2012, the Board of Directors of the Company approved the fiscal year 2013 Long Term Incentive Plan (2013 LTIP) for the executive officers. The 2013 LTIP is an equity based plan with a grant date of October 22, 2012 and contains a performance and service based restricted stock grant of 11,861 shares in the aggregate, subject to adjustment, with a vesting date of August 31, 2015. Based on the fiscal year 2013 financial results, 11,861 additional shares of restricted stock (total of 23,722 shares) were earned and granted subsequent to the end of fiscal year 2013 in accordance with the performance measurement criteria. No further performance-based measurements apply to this award. Compensation expense is being recognized on a ratable basis over the vesting period.

In September 2013, the Board of Directors of the Company approved the fiscal year 2014 Long Term Incentive Plan (2014 LTIP) for the executive officers and other members of management. The 2014 LTIP is an equity based plan with a grant date of September 1, 2013 and contains the following equity components:

Restricted Shares (a) performance and service based restricted stock grant of 7,529 shares in the aggregate, subject to adjustment, with a vesting date of August 31, 2016. Compensation expense is recognized on a ratable basis over the vesting period based on quarterly probability assessments; (b) time-based restricted stock grant of 8,323 and 1,040 shares in the aggregate, with vesting dates of August 31, 2016 and August 31,

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CHASE CORPORATION

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(UNAUDITED)

In thousands, except share and per share amounts

2014, respectively. Compensation expense is recognized on a ratable basis over the vesting period.

Stock options options to purchase 25,969 shares of common stock in the aggregate with an exercise price of $29.72 per share. The options will vest in three equal annual allotments beginning on August 31, 2014 and ending on August 31, 2016. The options will expire on August 31, 2023. Compensation expense is recognized over the period of the award on an annual basis consistent with the vesting terms.

Note 6 Segment Data and Foreign Operations

The Company is organized into two operating segments, an Industrial Materials segment and a Construction Materials segment. The basis for this segmentation is distinguished by the nature of the products and how they are delivered to their respective markets. The Industrial Materials segment reflects specified products that are used in or integrated into another company s product with demand dependent upon general economic conditions. Industrial Materials products include insulating and conducting materials for wire and cable manufacturers, moisture protective coatings for electronics and printing services, laminated durable papers, and flexible composites, laminates for the packaging and industrial laminate markets, pulling and detection tapes used in the installation, measurement and location of fiber optic cables, water and natural gas lines, cover tapes essential to delivering semiconductor components via tape and reel packaging, and wind energy composite materials and elements. Additionally, the Industrial Materials segment includes a joint venture which produces glass based strength elements designed to allow fiber optic cables to withstand mechanical and environmental strain and stress. The Construction Materials segment reflects construction project oriented product offerings that are primarily sold and used as Chase branded products. Construction Materials products include protective coatings for pipeline applications, coating and lining systems for use in liquid storage and containment applications, high performance polymeric asphalt additives, and expansion and control joint systems for use in the transportation and architectural markets.

The following tables summarize financial information about the Company s reportable segments:

	Three Months Ended November 30,	
	2013	2012
Revenues from external customers		
Industrial Materials	$ 41,670	$ 39,850
Construction Materials	12,513	13,550
Total	$ 54,183	$ 53,400
Income before income taxes		
Industrial Materials	$ 13,607	$ 5,530
Construction Materials	1,591	1,430

Total for reportable segments		15,198		6,960
Corporate and Common Costs		(1,634)		(1,663)
Total	$	13,564	$	5,297

The Company s products are sold world-wide. For the three months ended November 30, 2013 and 2012, sales from its operations located in the United Kingdom accounted for 8% of consolidated revenues in each period. No foreign geographic area accounted for more than 10% of consolidated revenues for the three months ended November 30, 2013 and 2012.

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

	November 30, 2013	August 31, 2013
Total assets		
Industrial Materials	$ 136,686	$ 133,110
Construction Materials	48,041	48,573
Total for reportable segments	184,727	181,683
Corporate and Common Assets	50,048	42,677
Total	$ 234,775	$ 224,360

As of November 30, 2013 and August 31, 2013, the Company had long-lived assets (defined as tangible assets providing the Company with a future economic benefit beyond the current year or operating period, including buildings, equipment and leasehold improvements) of $4,212 and $4,063, respectively, located in the United Kingdom. These balances exclude goodwill and intangibles of $10,618 and $10,333, as of November 30, 2013 and August 31, 2013, respectively.

Note 7 Goodwill and Other Intangibles

The changes in the carrying value of goodwill, by reportable segment, are as follows:

	Construction Materials	Industrial Materials	Consolidated
Balance at August 31, 2013	$ 10,735	$ 27,080	$ 37,815
Foreign currency translation adjustment	13	264	277
Balance at November 30, 2013	$ 10,748	$ 27,344	$ 38,092

The Company s goodwill is allocated to each reporting unit based on the nature of the products manufactured by the respective business combinations that originally created the goodwill. The Company identified several reporting units within each of its two operating segments that are used to evaluate the possible impairment of goodwill. Goodwill impairment exists when the carrying amount of goodwill exceeds its fair value. Assessments of possible impairment of goodwill are made when events or changes in circumstances indicate that the carrying value of the asset may not be recoverable through future operations. Additionally, testing for possible impairment of recorded goodwill and certain intangible asset balances is required annually. The amount and timing of any impairment charges based on these assessments require the estimation of future cash flows and the fair market value of the related assets based on management s best estimates of certain key factors, including future selling prices and volumes, operating, raw material and energy costs, and various other projected operating and economic factors. When testing, fair values of the reporting units and the related implied fair values of their respective goodwill are established using public company analysis and discounted cash flows. The Company evaluates the possible impairment of goodwill annually each fourth quarter and whenever events or circumstances indicate the carrying value of goodwill may not be recoverable.

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

Intangible assets subject to amortization consist of the following as of November 30, 2013 and August 31, 2013:

	Weighted-Average Amortization Period	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
November 30, 2013				
Patents and agreements	11.9 years	$ 3,237	$ 2,217	$ 1,020
Formulas	9.1 years	5,834	2,423	3,411
Trade names	5.7 years	6,394	2,354	4,040
Customer lists and relationships	10.2 years	34,646	12,185	22,461
		$ 50,111	$ 19,179	$ 30,932
August 31, 2013				
Patents and agreements	11.9 years	$ 3,198	$ 2,200	$ 998
Formulas	9.1 years	5,772	2,238	3,534
Trade names	5.7 years	6,345	2,055	4,290
Customer lists and relationships	10.2 years	34,020	11,061	22,959
		$ 49,335	$ 17,554	$ 31,781

Aggregate amortization expense related to intangible assets for the three months ended November 30, 2013 and 2012 was $1,194 and $1,217, respectively. Estimated amortization expense for the remainder of fiscal year 2014 and for each of the five succeeding fiscal years is as follows:

Years ending August 31,	
2014 (remaining 9 months)	$ 3,700
2015	4,750
2016	4,687
2017	4,250
2018	4,019
2019	3,322
	$ 24,728

Note 8 Sale of Insulfab Product Line

On October 7, 2013, the Company sold substantially all of its property and assets, including intellectual property, comprising the Insulfab® product line, to an unrelated third party (buyer). The Insulfab product line is primarily focused on manufacturing high quality, engineered barrier laminates used in aerospace applications. The sale proceeds of $7,394 are subject to certain post-closing adjustments based on the change in the final net book value compared to the bid date net book value. As of November 30, 2013, management determined these

post-closing adjustments resulted in an increase in the sale proceeds of $2,516 based on the increase of inventory sold to the buyer at closing. This adjustment is subject to final review by the buyer. The net proceeds from the sale are available for debt reduction and investment in the Company s core businesses.

This transaction resulted in a pre-tax book gain of $5,706 ($3,709 after-tax gain) which was recorded in the quarter ending November 30, 2013. The additional proceeds of $2,516 and the portion of the sale price held in escrow of $739 are recorded as current assets (Due from sale of product line) as of November 30, 2013.

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

The following table summarizes information about the Insulfab product line as of October 7, 2013 and August 31, 2013:

	October 7, 2013	August 31, 2013
Inventory	$ 3,153	$ 885
Property & equipment	1,062	1,060
Accrued expenses	(3)	(40)
	$ 4,212	$ 1,905

As a result of the efforts to market and sell this product line in the fourth quarter of fiscal 2013, the Company had classified the Insulfab assets (including inventory and equipment) as assets held for sale as of August 31, 2013. This product line and related assets were part of the Company s Industrial Materials segment.

Note 9 Joint Venture

The NEPTCO JV LLC (JV) was originally formed in 2003 by NEPTCO and a joint venture partner, an otherwise unrelated party (collectively, the members), whereby each member s fiber optic strength elements businesses were combined. This venture, which is 50% owned by each member, is managed and operated on a day-to-day basis by NEPTCO. The JV operates out of the Company s Granite Falls, NC facility.

The Company accounts for the joint venture partner s non-controlling interest in the JV under ASC Topic 810 Consolidations (ASC 810). Based on the criteria in ASC 810, the Company determined that the JV qualifies as a variable interest entity (VIE). Because of the Company s controlling financial interest, the JV s assets and liabilities and results of operations have been consolidated within the Company s consolidated financial statements since June 27, 2012, the date the Company acquired NEPTCO. An offsetting amount equal to 50% of net assets and net income (loss) of the JV has been recorded within the Company s consolidated financial statements to the non-controlling interest, representing the joint venture partner s 50% ownership interest and pro rata share in the JV.

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

At November 30, 2013 and August 31, 2013, the following amounts were consolidated in the Company s balance sheets related to the JV:

	November 30, 2013	August 31, 2013
Assets		
Cash	$ 523	$ 394
Accounts receivable, net	1,041	1,106
Inventories	1,747	1,510
Prepaid expenses and other assets	285	283
Property, plant and equipment, net	418	448
Intangible assets, net	699	706
Total assets	$ 4,713	$ 4,447
Liabilities and net assets		
Accounts payable and accrued expenses	$ 721	$ 679
Due to Members	1,816	1,677
Total liabilities	$ 2,537	$ 2,356
Net assets	$ 2,176	$ 2,091
Non-controlling interest	$ 1,088	$ 1,046

Effective on the date of the JV s inception, and for four years following the date on which the members no longer own any membership interest in the JV, non-compete agreements exist between the members. Each member retains the right to tender an offer to buy the other member s share. Once an offer is tendered, the tendered member has the option to either sell, or match the initial offer to purchase the tendering member s share.

Under the JV agreement, the JV is barred from issuing third party debt, other than customary accounts payable, resulting from its normal trade operations. The liabilities of the JV are not guaranteed by any portion of NEPTCO or the Company.

The JV agrees to purchase a minimum of 80% of its total glass fiber requirements from the other joint venture partner. Additionally, the JV agrees to purchase private-label products exclusively from an affiliate of the other joint venture partner; however, the JV is not subject to a minimum purchase requirement on private-label products. Purchases from the joint venture partner totaled $467 and $463 for the three months ended November 30, 2013 and 2012, respectively. The JV had amounts due to the other joint venture partner of $356 and $378 at November 30, 2013 and August 31, 2013, respectively.

Note 10 Commitments and Contingencies

The Company is involved from time to time in litigation incidental to the conduct of its business. Although the Company does not expect that the outcome in any of these matters, individually or collectively, will have a material adverse effect on its financial condition, results of operations or cashflows, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered that could adversely affect the Company s operating results or cash flows in a particular period. The Company routinely assesses all of its litigation and threatened litigation as to the probability of ultimately incurring a liability, and records its best estimate of the ultimate loss in situations where the Company assesses the likelihood of loss as probable.

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

Note 11 - Pensions and Other Post Retirement Benefits

The components of net periodic benefit cost for the three months ended November 30, 2013 and 2012 are as follows:

	Three Months Ended November 30,	
	2013	2012
Service cost	$ 81	$ 103
Interest cost	161	114
Expected return on plan assets	(178)	(149)
Amortization of prior service cost	1	6
Amortization of unrecognized loss	73	84
Curtailment loss		25
Settlement loss		327
Net periodic benefit cost	$ 138	$ 510

When funding is required, the Company s policy is to contribute amounts that are deductible for federal income tax purposes. As of November 30, 2013, the Company has made contributions of $200 in the current fiscal year to fund its obligations under its pension plan and will make the necessary contributions over the remainder of fiscal 2014 to ensure the qualified plan continues to be adequately funded given the current market conditions.

Note 12 Fair Value Measurements

The Company defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company uses a three-tier fair value hierarchy, which classifies the inputs used in measuring fair values. These tiers include: Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The Company utilizes the best available information in measuring fair value. Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. The financial assets classified as Level 1 as of November 30, 2013 and August 31, 2013 represent investments that are restricted for use in a nonqualified retirement savings plan for certain key employees and directors.

The following table sets forth the Company s financial assets that were accounted for at fair value on a recurring basis as of November 30, 2013 and August 31, 2013:

			Fair value measurement category		
	Fair value measurement date	**Total**	**Quoted prices in active markets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:					
Restricted investments	November 30, 2013	$ 1,229	$ 1,229	$	$
Restricted investments	August 31, 2013	$ 1,094	$ 1,094	$	$

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CHASE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In thousands, except share and per share amounts

The following table presents the fair value of the Company s long-term debt as of November 30, 2013 and August 31, 2013, which is recorded at its carrying value:

			Fair value measurement category		
	Fair value measurement date	Total	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Liabilities:					
Long-term debt	November 30, 2013	$ 63,000	$	$ 63,000	$
Long-term debt	August 31, 2013	$ 64,400	$	$ 64,400	$

The carrying value of the long-term debt approximates its fair value, as the monthly interest rate is set based on the movement of the underlying market rates.

Note 13 Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income (loss), net of tax, were as follows:

	Restricted Investments	Change in Funded Status of Pension Plan	Foreign Currency Translation Adjustment	Total
Balance at August 31, 2013	$ 144	$ (3,578)	$ (1,729)	$ (5,163)
Other comprehensive gains (losses) before reclassifications (1)	74		1,578	1,652
Reclassifications to net income of previously deferred (gains) losses (2)	(3)	48		45
Other comprehensive income (loss)	71	48	1,578	1,697
Balance at November 30, 2013	$ 215	$ (3,530)	$ (151)	$ (3,466)

(1) Net of tax benefit of $40, $0, $0, respectively.

(2) Net of tax expense of $2, tax benefit of $26, $0, respectively.

The following table summarizes the reclassifications from accumulated other comprehensive income (loss) to the unaudited condensed consolidated statements of income:

	Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income Three Months Ended November 30, 2013		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income
Gains on Restricted Investments:			
Realized gain on sale of restricted investments	$	5	Selling, general and administrative expenses
Tax expense (benefit)		2	
Gain net of tax	$	3	
Loss on Funded Pension Plan adjustments:			
Realized loss on amortization of prior pension service costs and unrecognized losses	$	(20)	Cost of products and services sold
Realized loss on amortization of prior pension service costs and unrecognized losses	$	(54)	Selling, general and administrative expenses
Tax expense (benefit)		26	
(Loss) net of tax	$	(48)	
Total net (loss) reclassified for the period	$	(45)	

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Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides an analysis of our financial condition and results of operations and should be read in conjunction with the unaudited Consolidated Financial Statements and notes thereto included in Item 1 of Part I of this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K filed for the fiscal year ended August 31, 2013.

Overview

Revenue and profit increases in the first three months of fiscal 2014 over the prior year period reflect the on-going benefits from production facility consolidation, efficiency improvements, favorable sales mix and strong demand. Additionally, the sale of the Company s Insulfab product line in October 2013 significantly contributed to earnings and cash flows in the first quarter of fiscal 2014. Revenues from the Industrial Materials segment increased over the same period in the prior year primarily due to increased sales from our electronic coatings, electronic material cover tape, and wire and cable product sales. These increases were partially offset by a reduction in our laminated durable paper product sales in the current quarter as compared to those realized in the first quarter of the prior year.

Our Construction Materials segment observed decreased demand for our coating and lining system products and bridge and highway related construction products in the first quarter of fiscal 2014 that resulted in lower sales and profits in the current quarter compared to the prior year period. This segment was positively impacted in the prior year period by certain large, non-recurring projects that were not repeated in the first three months of fiscal 2014. These decreases were partially offset by increased demand for our pipeline products and private label products produced at our North America facilities.

The upcoming second fiscal quarter has historically generated lower quarterly revenues for many of our product lines, especially within the Construction Materials segment. Our key objectives include our on-going global ERP system implementation which will continue through December 2014, as well as key strategies that focus on our marketing and product development efforts and continued emphasis on identifying potential acquisition targets. Our balance sheet remains strong, with cash on hand of $36.9 million and a current ratio of 2.9. Our $15.0 million line of credit is fully available, while the balance of our term debt is $63.0 million.

We have two reportable segments as summarized below:

Segment	Product Lines	Manufacturing Focus and Products
Industrial Materials	• Wire and Cable • Electronic Coatings • Specialty Products • Pulling and Detection • Electronic Materials • Structural Composites • Fiber Optic Cable Components (JV)	Protective coatings and tape products including insulating and conducting materials for wire and cable manufacturers, moisture protective coatings for electronics and printing services, laminated durable papers, packaging and industrial laminate markets, pulling and detection tapes used in the installation, measurement and location of fiber optic cables, water and natural gas lines, cover tapes essential to delivering semiconductor components via tape and reel packaging, and wind energy composite materials and elements; a joint venture also produces glass-based strength

		elements designed to allow fiber optic cables to withstand mechanical and environmental strain and stress.
Construction Materials	• Pipeline • Bridge & Highway • Coating & Lining Systems • Private Label	Protective coatings and tape products including coating and lining systems for use in liquid storage and containment applications, protective coatings for pipeline and general construction applications, high-performance polymeric asphalt additives, and expansion and control joint systems for use in the transportation and architectural markets.

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Results of Operations

Revenues and Operating Profit by Segment are as follows (Dollars in Thousands):

	Three Months Ended November 30, 2013	% of Total Revenues	Three Months Ended November 30, 2012	% of Total Revenues
Revenues from external customers				
Industrial Materials	$ 41,670	77%	$ 39,850	75%
Construction Materials	12,513	23%	13,550	25%
Total	$ 54,183		$ 53,400	

	Three Months Ended November 30, 2013	% of Segment Revenues	Three Months Ended November 30, 2012	% of Segment Revenues
Income before income taxes				
Industrial Materials	$ 13,607(a)	33%	$ 5,530(b)	14%
Construction Materials	1,591	13%	1,430(c)	11%
Total for reportable segments	15,198	28%	6,960	13%
Corporate and Common Costs	(1,634)		(1,663)	
Total	$ 13,564	25%	$ 5,297	10%

(a) Includes $5,706 gain on sale of Insulfab product line

(b) Includes $564 of costs of products sold related to inventory step up in fair value as part of the NEPTCO acquisition, $267 of pension related settlement costs due to the timing of lump sum distributions, and $150 of Randolph, MA plant closing expenses

(c) Includes $85 of pension related settlement costs due to the timing of lump sum distributions

Total Revenues

Total revenues increased $783,000 or 1% to $54,183,000 for the quarter ended November 30, 2013 compared to $53,400,000 in the same quarter of the prior year. Revenues in our Industrial Materials segment increased $1,820,000 or 5% to $41,670,000 for the quarter ended November 30, 2013 compared to $39,850,000 in the same quarter of the prior year. The increase in revenues from our Industrial Materials segment in the current quarter was primarily due to the following: (a) increased sales of $816,000 from our wire & cable products that service the power cable tapes and industrial power markets; (b) increased sales of $796,000 from our electronic coatings products resulting from higher sales in the European and Asian markets; and (c) increased sales of $1,031,000 from the electronic cover tapes market. These increases were partially offset by decreased sales of $491,000 from our laminated durable paper products, as well as reduced sales of $208,000 from our Insulfab product line that was sold in the first week of October 2013.

Revenues from our Construction Materials segment decreased $1,037,000 or 8% to $12,513,000 in the current quarter compared to $13,550,000 in the same period last year. The reduced sales from this segment was primarily due to decreased sales of $857,000 of our coating and lining

systems (CIM Industries), as well as lower sales of $356,000 from our bridge and highway products.

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Cost of Products and Services Sold

Cost of products and services sold decreased $1,793,000 or 5% to $35,478,000 in the quarter ended November 30, 2013 compared to $37,271,000 in the same period in fiscal 2013.

The following table summarizes our costs of products and services sold as a percentage of revenues for each of our reporting segments:

	Three Months Ended November 30,	
Cost of products and services sold	**2013**	**2012**
Industrial Materials	64.9%	69.5%
Construction Materials	67.5%	70.8%
Total	65.5%	69.8%

Cost of products and services sold in our Industrial Materials segment was $27,033,000 for the first three months of fiscal 2014 compared to $27,677,000 for the same period in the prior year. As a percentage of revenues, cost of products and services sold in the Industrial Materials segment decreased primarily due to the prior year period being impacted by the inclusion of $564,000 from the sale of inventory which had a stepped up valuation as part of the NEPTCO acquisition, $176,000 of pension related settlement costs due to the timing of lump sum distributions, and $150,000 of Randolph, MA plant transition expenses.

Cost of products and services sold in our Construction Materials segment was $8,445,000 in the current quarter compared to $9,594,000 for the same period last year. As a percentage of revenues, cost of products and services sold in the Construction Materials segment decreased in the current quarter primarily due to product mix as we had decreased sales from our lower margin products within this segment. We continue to closely monitor raw material pricing across all product lines in this segment to preserve margins.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased $100,000 or 1% to $10,439,000 in the quarter ended November 30, 2013 compared to $10,539,000 in the same period in fiscal 2013. As a percentage of revenues, selling, general and administrative expenses decreased to 19% in the first quarter of fiscal 2014 compared to 20% in the prior year period. The percentage decrease is primarily attributable to our continued emphasis on controlling costs and leveraging fixed overhead wherever possible. Additionally, the prior year period included $176,000 of pension related settlement costs due to the timing of lump sum distributions.

Interest Expense

Interest expense decreased $59,000 or 16% to $303,000 in the quarter ended November 30, 2013, compared to $362,000 in the same period in fiscal 2013. The decrease in interest expense from the prior year period is a direct result of a reduction in the Company s overall debt balance through principal payments made from operating cash flow over the past year.

Gain on sale of product line

On October 7, 2013, the Company sold substantially all of its property and assets, including intellectual property, comprising the Insulfab product line, to an unrelated third party buyer. This transaction resulted in a pre-tax book gain of $5,706,000, which was recorded in the current fiscal quarter ended November 30, 2013.

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Other Income (Expense)

Other expense decreased $174,000 to $105,000 in the quarter ended November 30, 2013 compared to other income of $69,000 in the same period in the prior year. Other income (expense) primarily includes interest income and foreign exchange gains (losses) caused by changes in exchange rates on transactions or balances denominated in currencies other than the functional currency of our subsidiaries.

Non-controlling Interest

The income (loss) from non-controlling interest relates to a joint venture in which we have, through our NEPTCO subsidiary, a 50% ownership interest. The joint venture between NEPTCO and its joint venture partner (an otherwise unrelated party) is managed and operated on a day-to-day basis by NEPTCO. The purpose of this joint venture was to combine the elements of each member s fiber optic strength elements businesses.

Net Income

Net income attributable to Chase Corporation increased $5,235,000 or 148% to $8,775,000 in the quarter ended November 30, 2013 compared to $3,540,000 in the same quarter of the prior year. The increase in net income in the current quarter is primarily due to the previously mentioned $5,706,000 gain that resulted from the sale of the Insulfab product line in October 2013. Additionally, the prior year results included incremental expenses of $564,000 in inventory fair value step up related to the NEPTCO acquisition during the first quarter, and the acceleration of defined benefit plan settlement costs of $352,000 resulting from the timing of lump sum distributions to participants.

Other Important Performance Measures

We believe that EBITDA and Adjusted EBITDA are useful performance measures. They are used by our executive management team and board of directors to measure operating performance, to allocate resources, to evaluate the effectiveness of our business strategies and to communicate with our board of directors and investors concerning our financial performance. EBITDA and Adjusted EBITDA are non-GAAP financial measures.

We define EBITDA as follows: net income attributable to Chase Corporation before interest expense from borrowings, income tax expense, depreciation expense from fixed assets, and amortization from intangible assets. We define Adjusted EBITDA as EBITDA excluding costs and gains/losses related to our acquisitions and disposals, costs of products sold related to inventory step-up to fair value, and settlement (gains) or losses resulting from lump sum distributions to participants from our defined benefit plan.

The use of EBITDA and Adjusted EBITDA has limitations and these performance measures should not be considered in isolation from, or as an alternative to, U.S. GAAP measures such as net income. Our measurement of Adjusted EBITDA may not be comparable to similarly titled measures used by other companies.

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The following unaudited table provides a reconciliation of net income attributable to Chase Corporation, the most directly comparable financial measure presented in accordance with U.S. GAAP, to EBITDA and Adjusted EBITDA for the periods presented:

	Three Months Ended November 30, 2013	2012
Net income attributable to Chase Corporation	$ 8,775,000	$ 3,540,000
Interest expense	303,000	362,000
Income taxes	4,747,000	1,820,000
Depreciation expense	1,426,000	1,508,000
Amortization expense	1,194,000	1,217,000
EBITDA	$ 16,445,000	$ 8,447,000
Gain on sale of Insulfab (a)	(5,706,000)	
Cost of sale of inventory step-up (b)		564,000
Pension curtailment and settlement costs (c)		352,000
Adjusted EBITDA	$ 10,739,000	$ 9,363,000

(a) Represents gain on sale of Insulfab product line that was completed in October 2013

(b) Represents costs of product related to the step-up in fair value of inventory through purchase accounting from the June 2012 acquisition of NEPTCO

(c) Represents pension related settlement costs due to the timing of lump sum distributions

Liquidity and Sources of Capital

Our overall cash and cash equivalents balance increased $6,931,000 to $36,928,000 at November 30, 2013, from $29,997,000 at August 31, 2013. The increased cash balance is primarily attributable to the proceeds from the sale of the Insulfab product line in October 2013 as well as from cash from operations, partially offset by payments on: outstanding debt, income taxes, annual incentive compensation and equipment purchases. A portion of cash held as of November 30, 2013 was subsequently used in December 2013 to pay our annual dividend of $4,093,000. We will continue to review our current cash balances denominated in foreign currency in light of current tax guidelines, working capital requirements, infrastructure improvements and potential acquisitions.

Cash flow provided by operations was $1,983,000 in the first quarter of fiscal 2014 compared to $2,116,000 in the prior year s first quarter. Cash provided by operations during the first three months of fiscal 2014 was primarily due to operating income, decreased accounts receivable and increased accounts payable balances offset by increased inventory and other current assets balances, as well as decreased accrued expenses due to the payment of our annual incentive compensation.

The ratio of current assets to current liabilities was 2.9 as of November 30, 2013, compared to 3.1 as of August 31, 2013. The decrease in our current ratio at November 30, 2013 was primarily attributable to increased accounts payable as well as an accrual for our fiscal 2013 annual dividend which was declared in the first fiscal quarter ending November 30, 2013 and paid in December 2013. This was partially offset by an increase in current assets due to the remaining open receivable amount for the sale of the Insulfab product line and increased inventory resulting

from higher sales volume and strategic raw material purchases, as well as decreased accrued payroll and other compensation due to the payment of our annual incentive program.

Cash flow provided by investing activities of $5,796,000 was primarily due to the proceeds from the sale of the Insulfab product line in October 2013, which was partially offset by cash paid for purchases of machinery and equipment at our manufacturing locations during the first quarter of fiscal 2014.

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Cash flow used in financing activities of $1,400,000 was due to payments made on the bank loans used to finance our acquisition of NEPTCO, described in more detail below.

On October 23, 2013, we announced an annual cash dividend of $0.45 per share (totaling $4,093,000), to shareholders of record on November 5, 2013 and payable on December 4, 2013.

In June 2012, as part of our acquisition of NEPTCO, we borrowed $70,000,000 under a five year term debt financing arrangement led and arranged by Bank of America, with participation from RBS Citizens (the Credit Facility). The applicable interest rate is based on the effective LIBOR plus a range of 1.75% to 2.25%, depending on our consolidated leverage ratio. At November 30, 2013, the applicable interest rate was 1.91% per annum and the outstanding principal amount was $63,000,000. We are required to repay the principal amount of the term loan in quarterly installments of $1,400,000 beginning in September 2012 through June 2014, increasing to $1,750,000 per quarter thereafter through June 2015, and to $2,100,000 per quarter thereafter through March 2017. The Credit Facility matures in June 2017 and prepayment of the Credit Facility is allowed at any time.

We have a revolving line of credit with Bank of America (the Revolver) totaling $15,000,000, which bears interest at LIBOR plus a range of 1.75% to 2.25%, depending on our consolidated leverage ratio, or, at our option, at the bank s base lending rate. As of November 30, 2013 and December 31, 2013, the entire amount of $15,000,000 was available for use. The Revolver is scheduled to mature in June 2017. This Revolver allows for increased flexibility for working capital requirements going forward, and we plan to use this availability to help finance our cash needs, including potential acquisitions, in fiscal 2014 and future periods.

The Credit Facility with Bank of America contains customary affirmative and negative covenants that, among other things, restrict our ability to incur additional indebtedness. It also requires us to maintain a ratio of consolidated indebtedness to consolidated EBITDA (each as defined in the facility) of no more than 3.00 to 1.00, and to maintain a consolidated fixed charge coverage ratio (as calculated in the facility) of at least 1.25 to 1.00. We were in compliance with our debt covenants as of November 30, 2013.

We currently have several on-going capital projects that are important to our long term strategic goals. Machinery and equipment will also be added as needed to increase capacity or enhance operating efficiencies in our other manufacturing plants.

We may also consider the acquisition of companies or other assets in fiscal 2014 or in future periods which are complementary to our business. We believe that our existing resources, including cash on hand and our Revolver, together with cash generated from operations and additional bank borrowings, will be sufficient to fund our cash flow requirements through at least the next twelve months. However, there can be no assurances that additional financing will be available on favorable terms, if at all.

To the extent that interest rates increase in future periods, we will assess the impact of these higher interest rates on the financial and cash flow projections of our potential acquisitions.

We have no significant off balance sheet arrangements.

Contractual Obligations

Please refer to Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations section in our Annual Report on Form 10-K for the fiscal year ended August 31, 2013 for a complete discussion of our contractual obligations.

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Recent Accounting Standards

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income . This ASU expands the presentation of changes in accumulated other comprehensive income. The new guidance requires an entity to disaggregate the total change of each component of other comprehensive income either on the face of the net income statement or as a separate disclosure in the notes. ASU 2013-02 is effective for fiscal years beginning after December 15, 2012. We adopted this ASU in the first quarter of fiscal 2014. The provisions of ASU 2013-02 did not have a material impact on our consolidated financial position, results of operations or cash flows.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States. To apply these principles, we must make estimates and judgments that affect our reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. In many instances, we reasonably could have used different accounting estimates and, in other instances, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations will be affected. We base our estimates and judgments on historical experience and other assumptions that we believe to be reasonable at the time and under the circumstances, and we evaluate these estimates and judgments on an ongoing basis. We refer to accounting estimates and judgments of this type as critical accounting policies, judgments, and estimates. Management believes there have been no material changes during the three months ended November 30, 2013 to the critical accounting policies reported in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended August 31, 2013.

Forward Looking Information

The part of this Quarterly Report on Form 10-Q captioned Management s Discussion and Analysis of Financial Condition and Results of Operations contains certain forward-looking statements, which involve risks and uncertainties. Forward-looking statements include, without limitation, statements as to our future operating results, plans for manufacturing facilities, future economic conditions and expectations or plans relating to the implementation or realization of our strategic goals and future growth. These statements are based on current expectations, estimates and projections about the industries in which we operate, and the beliefs and assumptions made by management. Readers should refer to the discussions under Forward Looking Information and Risk Factors contained in our Annual Report on Form 10-K for the fiscal year ended August 31, 2013 concerning certain factors that could cause our actual results to differ materially from the results anticipated in such forward-looking statements. These discussions and Risk Factors are hereby incorporated by reference into this Quarterly Report.

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Item 3 - Quantitative and Qualitative Disclosures about Market Risk

We limit the amount of credit exposure to any one issuer. At November 30, 2013, other than our restricted investments (which are restricted for use in a non-qualified retirement savings plan for certain key employees and members of the Board of Directors), all of our funds were either in demand deposit accounts or investment instruments that meet high credit quality standards such as money market funds, government securities, or commercial paper.

Our domestic operations have limited currency exposure since substantially all transactions are denominated in U.S. dollars (USD). However, our European operations are subject to currency exchange fluctuations. We continue to review our policies and procedures to reduce this exposure while maintaining the benefit from these operations and sales to other European customers. As of November 30, 2013, the Company had cash balances in the following foreign currencies (with USD equivalents):

Currency Code	Currency Name		USD Equivalent at November 30, 2013
GBP	British Pound	$	8,448,000
EUR	Euro	$	2,245,000
CNY	Chinese Yuan	$	264,000
CAD	Canadian Dollar	$	248,000

We will continue to review our current cash balances denominated in foreign currency in light of current tax guidelines, working capital requirements, infrastructure improvements and potential acquisitions.

We recognized a foreign currency translation gain for the three months ended November 30, 2013 in the amount of $1,578,000 related to our European operations, which is recorded in other comprehensive income (loss) within our Statement of Equity and Statement of Comprehensive Income. We do not have or utilize any derivative financial instruments.

Item 4 - Controls and Procedures

Evaluation of disclosure controls and procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carry out a variety of ongoing procedures under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, to evaluate the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of the end of the period covered by this report.

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Changes in internal control over financial reporting

Effective April 1, 2013, the Company began the process of implementing a single enterprise resource planning (ERP) computer system world-wide. During fiscal 2013 and the first quarter of fiscal 2014, the Company expanded its existing ERP modules to five of its domestic locations which resulted in changes to the Company s processes and procedures affecting its internal control over financial reporting. The Company expects this process to continue over the next twelve months as it continues with its plan to deploy more effective and efficient processes to support the Company s financial reporting as it continues to grow in size and scale. Otherwise, there have not been any changes in the Company s internal control over financial reporting during its most recent fiscal year that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

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Part II OTHER INFORMATION

Item 1 Legal Proceedings

We are involved from time to time in litigation incidental to the conduct of our business. Although we do not expect that the outcome in any of these matters, individually or collectively, will have a material adverse effect on our financial condition, results of operations or cashflows, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered, that could adversely affect our operating results or cash flows in a particular period. We routinely assess all of our litigation and threatened litigation as to the probability of ultimately incurring a liability, and record our best estimate of the ultimate loss in situations where we assess the likelihood of loss as probable.

Item 1A Risk Factors

Please refer to Item 1A in our Annual Report on Form 10-K for the fiscal year ended August 31, 2013 for a complete discussion of the risk factors which could materially affect our business, financial condition or future results.

Item 6 - Exhibits

Exhibit Number	Description
10.1	Chase Corporation Annual Incentive Plan for Fiscal Year 2014 (incorporated by reference from Exhibit 99.1 to the Company s current report on Form 8-K filed October 11, 2013).
10.2	Chase Corporation Long-Term Incentive Plan for Fiscal Year 2014 (incorporated by reference from Exhibit 99.2 to the Company s current report on Form 8-K filed October 11, 2013).
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document**
101.SCH	XBRL Taxonomy Extension Schema Document**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document**

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* Identifies management plan or compensatory plan or arrangement.

** Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise

are not subject to liability under those sections.

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SIGNATURES

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

Chase Corporation

Dated: January 9, 2014	By:	/s/ Peter R. Chase Peter R. Chase, Chairman and Chief Executive Officer
Dated: January 9, 2014	By:	/s/ Kenneth L. Dumas Kenneth L. Dumas, Chief Financial Officer and Treasurer