

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

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**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended March 31, 2009**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 0-18958**

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**Groen Brothers Aviation, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

**Utah**  
(State or other jurisdiction of  
incorporation or organization)

**87-0489865**  
(I.R.S. Employer  
Identification No.)

**2640 West California Avenue**  
**Salt Lake City, Utah 84104-4593**  
(Address of principal executive offices, including zip code)

**(801) 973-0177**  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). The registrant has not yet been phased into the Interactive Data reporting system.

Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of March 31, 2009 and April 27, 2010, there were 171,416,289 shares of the Registrant's common stock, no par value per share, outstanding.

**CAUTIONARY STATEMENT REGARDING THE FILING DATE OF THIS REPORT  
AND THE ANTICIPATED FUTURE FILINGS OF ADDITIONAL PAST-DUE  
REPORTS**

This Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2009 is first being filed in April 2010. The Company is in the process of preparing its other periodic reports, including the Form 10-K for the fiscal year ended June 30, 2009, and plans to file such reports at the earliest practicable date. Shareholders and others are cautioned that the financial statements included in this report are over one year old and are not necessarily indicative of the operating results that may be expected for the years ending June 30, 2009 or 2010.

**GROEN BROTHERS AVIATION, INC.  
FORM 10-Q  
FOR THE QUARTER ENDED MARCH 31, 2009**

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## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

#### GROEN BROTHERS AVIATION, INC. Condensed Consolidated Balance Sheets

ASSETS	March 31, 2009	June 30, 2008
	(Unaudited)	
Current assets:		
Cash	\$ 189,000	\$ 3,000
Accounts receivable, net of allowance of \$7,000	20,000	14,000
Related party accounts and notes receivable	2,000	5,000
Prepaid expenses	13,000	6,000
Total current assets	224,000	28,000
Property and equipment, net	92,000	133,000
Total assets	\$ 316,000	\$ 161,000
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities:		
Bank overdraft	\$ -	\$ 22,000
Bank overdraft line of credit	-	47,000
Accounts payable	2,558,000	4,232,000
Accrued expenses	11,707,000	9,429,000
Notes payable	1,409,000	564,000
Related party notes payable	59,278,000	17,483,000
Series B 15% cumulative redeemable non-voting preferred stock, no par value, 50,000,000 shares authorized, 36,411 and 68,095 shares issued and outstanding, respectively	36,411,000	68,095,000
Total current liabilities	111,363,000	99,872,000
Long-term liabilities:		
Accrued expenses	5,478,000	5,192,000
Deferred revenue	25,000	25,000
Long-term debt	97,000	102,000
Related party long-term debt	-	166,000
Dealer deposits	2,105,000	2,105,000
Total liabilities	119,068,000	107,462,000
Stockholders' deficit:		
Series A convertible preferred stock, no par value, 50,000,000 shares authorized, 1,400,000 shares issued and outstanding	70,000	70,000
Common stock, no par value, 500,000,000 shares authorized, 171,416,289 shares issued and outstanding	34,620,000	34,390,000
Accumulated deficit	(153,442,000)	(141,761,000)
Total stockholders' deficit	(118,752,000)	(107,301,000)
Total liabilities and stockholders' deficit	\$ 316,000	\$ 161,000

See accompanying notes to condensed consolidated financial statements

**GROEN BROTHERS AVIATION, INC.**  
**Condensed Consolidated Statements of Operations**  
**(Unaudited)**

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Revenues	\$ 469,000	\$ 2,214,000	\$ 853,000	\$ 5,783,000
Costs and expenses:				
Cost of sales	227,000	2,005,000	644,000	6,211,000
Research and development	81,000	70,000	246,000	746,000
General and administrative expenses	238,000	889,000	693,000	2,450,000
Total costs and expenses	546,000	2,964,000	1,583,000	9,407,000
Loss from operations	(77,000)	(750,000)	(730,000)	(3,624,000)
Other income (expense):				
Related party interest income	1,000	1,000	2,000	3,000
Interest and other income	-	18,000	1,000	24,000
Gain on sale of property and equipment	-	-	45,000	-
Gain on extinguishment of debt	-	23,000	-	47,000
Interest expense	(2,453,000)	(1,131,000)	(5,721,000)	(2,964,000)
Series B preferred stock interest expense	(1,316,000)	(2,373,000)	(5,278,000)	(6,863,000)
Total other income (expense)	(3,768,000)	(3,462,000)	(10,951,000)	(9,753,000)
Loss before income taxes	(3,845,000)	(4,212,000)	(11,681,000)	(13,377,000)
Income tax benefit	-	-	-	-
Net loss	\$(3,845,000)	\$ (4,212,000)	\$(11,681,000)	\$(13,377,000)
Net loss per common share – basic and diluted	\$ (0.02)	\$ (0.03)	\$ (0.07)	\$ (0.09)
Weighted average number of common shares outstanding – basic and diluted	166,066,000	154,080,000	166,066,000	151,269,000

See accompanying notes to condensed consolidated financial statements

**GROEN BROTHERS AVIATION, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

	Nine Months Ended March 31,	
	2009	2008
Cash flows from operating activities:		
Net loss	\$ (11,681,000)	\$ (13,377,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	40,000	186,000
Common stock issued for interest expense	-	455,000
Common stock issued for 401(k) expense	-	306,000
Stock options and warrants issued for interest expense	(6,000)	98,000
Stock options issued for services	6,000	9,000
Stock-based compensation	223,000	543,000
Interest expense accrued on Series B preferred stock	5,278,000	6,863,000
Interest expense added to debt principal	2,723,000	10,000
Gain on extinguishment of debt	-	(1,000)
Interest income on related party notes receivable	-	(3,000)
(Gain) loss on sale of property and equipment	(45,000)	44,000
(Increase) decrease in:		
Accounts and notes receivable	(6,000)	(503,000)
Prepaid expenses	(7,000)	(157,000)
Inventories	-	126,000
Increase (decrease) in:		
Accounts payable	(788,000)	(108,000)
Accrued expenses	2,572,000	2,803,000
Deferred revenue	-	(328,000)
Dealer deposits	-	(40,000)
Net cash used in operating activities	(1,691,000)	(3,074,000)
Cash flows from investing activities:		
Purchase of property and equipment	-	(6,000)
Proceeds from sale of property and equipment	27,000	-
Payments of related party notes receivable	2,000	2,000
Net cash provided by (used in) investing activities	29,000	(4,000)
Cash flows from financing activities:		
Proceeds from the issuance of debt	2,041,000	7,837,000
Repayment of debt	(124,000)	(4,950,000)
Repayment of bank overdraft	(22,000)	-
Repayment of bank overdraft line of credit	(47,000)	-
Proceeds from the issuance of common stock and stock options	-	132,000
Payment of finders' compensation on issuance of common stock	-	(1,000)
Net cash provided by financing activities	1,848,000	3,018,000
Net increase (decrease) in cash	186,000	(60,000)
Cash, beginning of period	3,000	60,000
Cash, end of period	\$ 189,000	\$ -

See accompanying notes to condensed consolidated financial statements

**GROEN BROTHERS AVIATION, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
**(Unaudited)**

**Note 1. Basis of Presentation**

**Organization and Consolidation**

The unaudited condensed consolidated financial statements include the accounts of Groen Brothers Aviation, Inc. (the “Company”) and its wholly owned subsidiary, Groen Brothers Aviation USA, Inc. (“GBA USA”), and include all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary to present fairly the financial position as of March 31, 2009 and the results of operations and cash flows for the three months and nine months ended March 31, 2009 and 2008. The results of operations for the nine months ended March 31, 2009 are not necessarily indicative of the results to be expected for the full fiscal year ending June 30, 2009.

**Basis of Presentation and Going Concern Uncertainty**

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Because of recurring operating losses, the excess of current liabilities over current assets, the stockholders’ deficit, and negative cash flows from operations, there is substantial doubt about the Company’s ability to continue as a going concern.

At March 31, 2009, the Company had total current liabilities of \$111,363,000 and current assets of \$224,000, resulting in a working capital deficiency of \$111,139,000. At March 31, 2009, the Company had a total stockholders’ deficit of \$118,752,000.

Following delays in our Heliplane program for the U.S. Defense Advanced Research Projects Agency (“DARPA”), lower than anticipated results from sales of our SparrowHawk kits, and negative conditions in capital markets, we effected a substantial reduction in force and have significantly scaled back the level of our operations.

Historically, the Company experienced a negative gross profit on sales of Sparrow Hawk kits and the number of SparrowHawk kits sold fell below expectations, due in part to lack of funding to finalize product development and to pay for increased sales and marketing efforts. In these circumstances, prospects of reaching a satisfactory profit level in a deteriorating economic climate were not promising. As importantly, the Company determined that the kit aircraft business, aimed at customers for their personal use could not be readily compatible with the design, manufacture and marketing of more sophisticated aircraft required by military and commercial customers. Therefore, in May 2008, the Company decided to cease production of the SparrowHawk and to seek to sell the program to a buyer with more compatible operating conditions and strategic interests. Consistent with this decision, and as part of its reduction in operations, the Company discontinued its SparrowHawk flight training and other flight operations at Buckeye Airport, Arizona and also terminated the lease on its primary hangar at that location. The Company retained its small leased hangar at Buckeye for storage and to maintain the ability to undertake flight tests or demonstration flights at that airport if needed.

The Company has also experienced a negative profit margin on the DARPA contract, which has reduced cash flows from operations. Subsequent to March 31, 2009, DARPA announced the award of the Heliplane prime contractor position to the Georgia Institute of Technology (GT) for Phase IB. Since then, the Company has been engaged as a GT subcontractor for rotor systems work of Phase IB.

The Company’s continuation as a going concern is dependent on attaining profitable operations, obtaining additional outside financing and/or restructuring its debt obligations, including its Series B Preferred Stock. The Company has funded losses from operations primarily from the issuance of debt to

related parties (current shareholders and lenders of the Company), the increase in accounts payable and accrued expenses, and the sale of the Company's restricted common stock in private placement transactions, and will require additional funding from these sources to sustain its future operations.

In order to repay its debt obligations in full or in part when due, the Company will be required to raise significant capital from other sources. Alternatively, the Company will be required to negotiate further extensions of the Series B Preferred Stock maturity date and its notes payable, as it has accomplished in the past. There is no assurance, however, that the Company will be successful in these efforts.

During 2006 and 2007, the Company obtained debt financing from the holders of the Series B Preferred Stock (the "Series B Holders") in the aggregate principal amount of \$4,400,000 (the "2006/2007 Notes"). The 2006/2007 Notes provide for the payment of simple interest at the rate of 36% per annum. The maturity date for the 2006/2007 Notes has been extended from time to time and currently is May 9, 2010.

Included in current liabilities and the working capital deficiency at March 31, 2009 is a \$36,411,000 Series B Preferred Stock obligation. The Series B Holders have agreed to extend the redemption date of the Series B Preferred Stock from time to time and the current redemption date is May 9, 2010, or such later date as agreed to in writing by at least 80% of the Series B Holders.

In October 2008, as part of a Note Purchase Agreement between the Company and the Series B Holders, the Company issued short-term interest bearing notes in the principal amount of \$36,962,000 in satisfaction of the accrued and unpaid dividends on the Series B Preferred Stock through October 9, 2008 (the "Dividend Notes"). Because the Company had paid such dividends in kind by issuing additional shares of Series B Preferred Stock, the issuance of the Dividend Notes resulted in the redemption of \$36,962,000 of Series B Preferred Stock. The Dividend Notes provide for the payment of interest at the rate of 15% per annum, compounded quarterly. The maturity date for the Dividend Notes has been extended from time to time and currently is May 9, 2010.

The Note Purchase Agreement, as amended, provides for the periodic sale by the Company to the lenders of short-term promissory notes in the aggregate principal amount of up to \$5,750,000 to provide the Company with operating capital, as specified in the draw requests for such notes (the "Note Purchase Notes"). The draw requests must be approved by the lenders. Through March 31, 2009, the lenders had purchased notes under the Note Purchase Agreement in the aggregate principal amount of \$1,935,000 and the proceeds had been used by the Company to cover its minimum cash needs in excess of funding provided by payments from Georgia Tech for the Company's work on the DARPA contract. The Note Purchase Notes provide for the payment of simple interest at the rate of 15% per annum. The maturity date for the Note Purchase Notes has been extended from time to time and currently is May 9, 2010.

Substantially all assets of the Company, including its intellectual property, have been pledged as collateral for the Company's debt.

There can be no guarantee or assurance that the Company will be successful in its ability to generate income from operations or from the DARPA contract, or to raise capital at favorable rates or at all. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

## Reclassifications

Certain amounts in the condensed consolidated financial statements for the three and nine months ended March 31, 2008 have been reclassified to conform to the current period presentation.

### Note 2: Loss Per Common Share

The computation of basic net loss per common share is computed using the weighted average number of common shares outstanding during each period. The computation of diluted net loss per common share is based on the weighted average number of shares outstanding during the period plus common stock equivalents which would arise from the exercise of stock options and warrants outstanding using the treasury stock method and the average market price per share during the period, as well as common shares issuable upon the conversion of debt to common stock. Common stock equivalents were not included in the diluted loss per share calculation because the effect would have been anti-dilutive.

The calculation of the weighted average number of common shares outstanding excludes common shares that have been issued as collateral for certain notes payable to related parties. These collateral shares are restricted and bear a legend prohibiting the holder from selling or transferring the shares at any time. The Company has assigned no value to these shares, and the terms of the notes payable require the holder of the collateral shares to return the shares to the Company when the applicable note and accrued interest are paid in full. At March 31, 2009, the Company had issued 5,350,000 shares of common stock as collateral.

### Note 3: Stock Based Compensation

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123(R), *Share Based Payments*. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the value of the award granted using the Black-Scholes option pricing model, and recognized over the period in which the award vests. The stock-based compensation expense for the three-month and nine-month periods ended March 31, 2009 and 2008 has been allocated to the various categories of operating costs and expenses in a manner similar to the allocation of payroll expense as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Cost of sales	\$ 32,000	\$ 81,000	\$ 96,000	\$ 136,000
Research and development	12,000	109,000	38,000	299,000
General and administrative	30,000	8,000	89,000	108,000
Total stock-based compensation expense	\$ 74,000	\$ 198,000	\$ 223,000	\$ 543,000

There was no stock compensation expense capitalized during the nine months ended March 31, 2009 and 2008.

During the nine months ended March 31, 2009, no new stock options or warrants were issued. The following table summarizes the stock option and warrant activity during the nine months ended March 31, 2009:

	<u>Options and Warrants</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contract Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at June 30, 2008	73,885,000	\$ 0.28		
Granted	-	-		
Exercised	-	-		
Cancelled	(9,555,000)	0.21		
Expired	<u>(10,177,000)</u>	0.32		
Outstanding at March 31, 2009	<u>54,153,000</u>	0.29	1.98	\$ 0
Options and warrants vested and exercisable at March 31, 2009	<u>43,541,000</u>	0.32	1.33	\$ 0

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of \$0.004 as of March 31, 2009, which would have been received by the holders of in-the-money options had the option holders exercised their options as of that date.

As of March 31, 2009, the total future compensation cost related to non-vested stock-options not yet recognized in the condensed consolidated statements of operations was approximately \$504,000, and the weighted average period over which these awards are expected to be recognized was 0.87 years.

#### **Note 4: Accrued Expenses**

Accrued expenses consisted of the following at March 31, 2009:

Compensation and related taxes	\$ 584,000
Related party interest	10,057,000
Interest	672,000
Customer deposits	260,000
Consulting fees	36,000
Finders' compensation	7,000
Royalties to related parties	32,000
Other	<u>59,000</u>
Total	<u>\$ 11,707,000</u>

Accrued related party interest payable is comprised of interest expense payable on notes payable to related parties, consisting primarily of stockholders of the Company.

Royalty payments totaling 1% of the gross sales price of gyroplanes are to be paid to the Company's founders, David Groen and the estate of the late Jay Groen. Through March 31, 2009, royalties payable totaled \$16,000 to each of these individuals, which amounts are accrued as a component of cost of sales in the condensed consolidated statements of operations.

Long-term accrued expenses consisted of the following at March 31, 2009:

Deferred compensation	\$ 5,003,000
Accrued payroll taxes on deferred compensation	176,000
Accrued interest on deferred compensation	<u>299,000</u>
Total	<u><u>\$ 5,478,000</u></u>

The deferred compensation is payable to certain current and former officers, directors, and senior management of the Company, with amounts originating from fiscal year 1998 through the current fiscal year. In addition to cash compensation, the Company has a deferred compensation arrangement for executive officers and certain of its senior management that accrues additional salary. The terms of the Company's Series B 15% Preferred Stock preclude the Company from making any deferred compensation payments until all outstanding amounts due relating to the Series B 15% Preferred Stock have been paid in full. Absent payment restrictions related to outstanding Series B 15% Preferred Stock or other restrictions, the deferred compensation is payable in part or in whole only by resolution of the Company's Board of Directors. Through March 31, 2009, the Board of Directors has not authorized payment of any of the deferred compensation, and will not authorize payments until the Board determines such payments are allowed under the Company's outstanding financing agreements and would be prudent in light of the Company's financial condition and availability of cash. In fiscal year 2001, the Company began accruing interest expense on the deferred compensation at the rate of 8% per annum. The accrual of interest was permanently discontinued on July 1, 2004. The deferred compensation and related accrued payroll taxes and interest payable are classified as long-term liabilities at March 31, 2009 as the Company does not anticipate payment of any of these amounts in the next twelve months.

**Note 5: Debt**

Included in short-term notes payable at March 31, 2009 are notes payable to vendors and others totaling \$523,000, substantially all of which are in default. The Company continues ongoing negotiations with certain of the vendors and has, in most instances, been granted grace periods and extensions without receipt of formal notices of default or threat of legal action.

Substantially all related party notes payable of \$59,278,000 at March 31, 2009 are payable to stockholders of the Company who are considered related parties, including the Series B Holders. The related party notes payable at March 31, 2009 are comprised of the following:

Series B Holders:	
Dividend Notes	\$39,670,000
Note Purchase Notes	1,935,000
2006/2007 Notes	<u>4,400,000</u>
	46,005,000
Other Related Parties	<u>13,273,000</u>
Total Related Party Notes Payable	<u><u>\$59,278,000</u></u>

Dividend Notes totaling \$39,670,000 (\$36,962,000 original principal plus \$2,708,000 in accrued interest expense added to note principal) resulted from the redemption of 36,962 shares of Series B Preferred Stock in October 2008. The Dividend Notes provide for the payment of interest at the rate of 15% per annum, compounded quarterly, and a rate of interest of 18% per annum during any period in which an event of default has occurred and is continuing. The maturity date for the Dividend Notes has also been extended from time to time and currently is May 9, 2010.

Pursuant to the Note Purchase Agreement discussed in Note 7, the Company borrowed a total of \$1,935,000 from the Series B Holders during the period October 1, 2008 to March 31, 2009. The Note Purchase Notes provide for the payment of simple interest at the rate of 15% per annum. The maturity date for the Note Purchase Notes has been extended from time to time and currently is May 9, 2010.

During 2006 and 2007, the Company also borrowed a total of \$4,400,000 through the issuance of other promissory notes payable to the Series B Holders that provide for the payment of simple interest at the rate of 36% per annum. The maturity date for the 2006/2007 Notes has been extended from time to time and currently is May 9, 2010.

The Company is delinquent in making payments on related party notes payable totaling \$6,207,000. The Company is also delinquent on making payments of accrued interest payable on debt of \$4,394,000, of which \$3,755,000 is payable to related parties.

#### **Note 6: Dealer Deposits**

Dealer deposits consist of amounts received from the Company's authorized dealers on aircraft in anticipation of full-scale production of the Company's Hawk 4 gyroplane. The deposit guarantees a delivery sequence number and represents a percentage of the total estimated purchase price. The Company has also issued common stock to dealers as partial consideration for the delay in the certification of the Hawk 4 gyroplane. These costs have been charged to interest expense as incurred. The dealers have been given the opportunity to convert a portion of their deposits into shares of the Company's restricted common stock. Those dealers that have converted deposits into shares and are now stockholders of the Company are considered related parties. The Company continues its efforts to obtain the funding to complete the certification of the Hawk 4. Once such funding is obtained, the Company estimates the certification process will require two to three years to complete. Because of the long-term prospects of obtaining the funding and completing the certification, dealer deposits have been recorded as long-term liabilities.

#### **Note 7: Preferred Stock**

The Company has authorized 200,000,000 shares of preferred stock having no par value. There are two series of preferred stock with 50,000,000 shares authorized within each series. The rights, terms and preferences of preferred stock are set by the Board of Directors. As of March 31, 2009, the Board of Directors has set rights, terms and preferences of Series A and Series B Preferred Stock for issue.

##### **Series A Convertible Preferred Stock**

As of March 31, 2009, 1,400,000 shares of Series A Convertible Preferred Stock were issued and outstanding, and held by the following: David Groen, President and member of the Board of Directors, 1,025,000 shares; Robin Wilson, member of the Board of Directors 125,000 shares; the widow of the late Jay Groen 125,000 shares; and Dennis Gauger, former member of the Board of Directors, 125,000 shares.

The rights, terms and preferences of the Series A Convertible Preferred Stock, as amended, are summarized as follows:

- Each share may cast one hundred (100) votes on all matters submitted to the stockholders for a vote, voting together with the holders of the common stock of the Company as a single class, effectively giving current voting control to the Company's founders.
- The voting rights expire seven years from the date of issue.

- Upon, and only upon, the Company reaching significant revenue milestones, the shares are convertible into common stock of the Company through payment of a cash conversion price of \$0.50 per share of common stock, convertible on a one-for-one hundred (1:100) basis (100 shares of common stock for each share of Series A Convertible Preferred Stock). Conversion is allowed at the rate of 25% of the preferred shares for each \$30 million in defined cumulative gross sales, for a total of \$120 million in sales. This convertibility is also only available if these significant revenue milestones are met within seven years from the date of issue of the Series A Convertible Preferred Stock.
- The shares, including all voting and conversion rights, to the extent not converted into common shares, will expire seven years from the date of issue, and will be cancelled by the Company.
- Upon the death or permanent incapacity of a holder of Series A Convertible Preferred Stock, all shares held by such holder will be divided equally between the then existing members of the Company's Board of Directors and the holder's survivor(s) (if more than one person, treated collectively as one person). Upon a temporary mental incapacity of a holder of Series A Convertible Preferred Stock, all shares will be voted by the remaining holders of the Series A Convertible Preferred Stock until the end of the temporary incapacity.
- The shares are non-transferable, non-assignable, and have no dividend or liquidation rights.

### **Series B Preferred Stock**

At March 31, 2009, there were 36,411 shares of Series B 15% Cumulative Redeemable Non-Voting Preferred Stock (the "Series B Preferred Stock") outstanding. The rights, terms, and preferences of the outstanding preferred shares, as amended, are as follows:

- The shares have no voting rights.
- Each share's original Stated Value, upon which unpaid dividends may accumulate, is \$1,000.
- The shares have right to dividends at a 15% annual dividend rate, payable in cash or in kind at the end of each fiscal quarter. Accumulated but unpaid dividends shall be cumulative and shall be added to the Stated Value for purposes of subsequent quarterly dividend calculations.
- The shares shall have superior liquidation priority to any other series of the Company's capital stock, equal to the Stated Value plus all accrued but unpaid dividends thereon.
- The redemption price of the shares must be paid by the Company in cash.
- The Company may incur indebtedness of up to \$18.5 million without consent of the holders of the shares.
- The Company is required to give notice to holders of the shares prior to making any capital expenditures in excess of \$300,000.
- The maturity date of the shares is defined as the first to occur of (a) June 15, 2007, or such later date as agreed to in writing by at least 80% of the Series B Holders, (b) the occurrence of a defined "liquidation event", or (c) the date that is six months following the receipt by the Company or its affiliates of proceeds from one or more financing transactions in excess of \$50 million.

- If the Company should default in its obligation under the Series B Preferred Stock, the Series B Holders may require the Company to redeem the Series B Preferred Stock by providing written notice three days prior to the requested redemption date.
- At any time after March 1, 2008, the holders of not less than 80% of the outstanding shares of Series B Preferred Stock may elect from time to time to have the outstanding shares of Series B Preferred Stock redeemed in whole or in part.
- The Company is required to make pro rata redemptions of the shares in the event the Company receives proceeds from certain financing transactions that exceed \$20 million in the aggregate.

On October 11, 2005, the Series B Holders extended the redemption date of the Series B Preferred Stock from October 31, 2005 to January 1, 2007. The extension required the following consideration to be paid to the Series B Holders:

- The cancellation on October 11, 2005 of existing warrants issued to the Series B Holders to purchase 2.5 million shares of the Company's common stock at an exercise price of \$0.30 per share.
- The issuance on October 11, 2005 of warrants to purchase 6.85 million shares of the Company's common stock exercisable through January 1, 2009 at an exercise price of \$0.30 per share.
- The issuance of additional shares of Series B Preferred Stock with a redemption value of \$10.7 million face value (10,700 shares) on January 1, 2007, with reductions in the number of shares to be issued allowed for repayments during the extension period of amounts due to the Series B Holders in accordance with an agreed-upon formula.

On February 13, 2007, the Series B Holders further extended the redemption date to May 1, 2007. On May 10, 2007, the Series B Holders agreed to an extension of the redemption date of the Series B Preferred Stock to June 16, 2007, or such later date as agreed to in writing by at least 80% of the Series B Holders. Subsequently, the Series B Holders agreed in writing to an extension of the redemption date June 16, 2007, to June 30, 2008.

On October 9, 2008, as part of a Note Purchase Agreement between the Company and the Series B Holders, the Company redeemed 36,962 shares of the Series B Preferred Stock with a book value of \$36,962,000, representing the cumulative total of dividends paid in kind through October 9, 2008. Short-term, interest bearing promissory notes totaling \$36,962,000 were issued to the Series B Holders in the redemption. The Series B Holders agreed to an extension of the redemption date of the remaining Series B Stock from June 30, 2008 to April 9, 2009.

The Note Purchase Agreement also provides for the periodic sale by the Company to the lenders of short-term promissory notes to provide the Company with operating capital, as specified in the draw requests for such notes. The draw requests must be approved by the lenders. Through March 31, 2009, the lenders had purchased notes under the Note Purchase Agreement in the aggregate principal amount of \$1,935,000 and the proceeds had been used by the Company to cover its minimum cash needs in excess of funding provided by payments from Georgia Tech for the Company's work on the DARPA contract. Subsequent to the end of January, 2009, the lenders and the Company have amended the October 9, 2008 Note Purchase Agreement five times to increase the aggregate amount of promissory notes that can be purchased to \$5,750,000, to provide funding to meet the Company's monthly minimum financial needs. The lenders are not obligated to purchase notes pursuant to the Note Purchase Agreement and there can be no assurance that the lenders will continue to purchase notes or otherwise provide funding to the Company.

Subsequent to March 31, 2009, the redemption date of the Series B Preferred Stock has been extended from time to time and currently is May 9, 2010, or such later date as agreed to in writing by the holders of at least 80% of the outstanding shares of Series B Preferred Stock.

In connection with the execution of the Note Purchase Agreement and the issuance of the Series B Preferred Stock, substantially all assets of the Company, including its intellectual property, have been pledged as collateral for the Company's debt.

The Company reviewed the requirements of Emerging Issues Task Force (EITF) No. 02-4, *Determining Whether a Debtor's Modification or Exchange of Debt Instruments Is Within the Scope of FASB Statement 15*, and determined that the extension of the redemption date of the original issuance of the Company's Series B Preferred Stock in October 2003 met the criteria of a troubled debt restructuring outlined in Statement of Financial Accounting Standards (SFAS) No. 15, *Accounting for Debtors and Creditors for Troubled Debt Restructurings*. No gain or loss was recorded on the October 2003 extension and subsequent extension of the due date in October 2005. The value of the warrants issued to the Series B Holders in connection with the extensions of the due dates, estimated by the Black-Scholes option pricing model, was charged to interest expense. The Series B Preferred Stock will be classified through its redemption as a troubled debt restructuring.

Included in the periodic interest expense on the Series B Preferred Stock is the accretion of the \$10,700,000 obligation to issue 10,700 shares of additional Series B Preferred Stock on January 1, 2007, calculated on the interest method. The 10,700 additional shares of Series B Preferred Stock were issued in January 2007.

As a result of amendments to the features of the Series B Preferred Stock, if the Company is successful in raising the levels of funding that it requires to bring its debt obligations current, fund its planned operations, and complete aircraft certification requirements for its Hawk 4 gyroplane, significant portions of this funding may be required to make redemption payments on the Series B Preferred Stock. At March 31, 2009, the recorded value of the Series B Preferred Stock was \$36,411,000, which was recorded as a current liability.

Statement of Financial Accounting Standards No. 150 (SFAS 150), "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. SFAS 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. Many of those instruments were previously classified as equity. The Company's Series B Preferred Stock is classified as a liability because it embodies an obligation of the Company and falls within the scope of SFAS 150. Preferred Stock accretion and dividends are expensed as interest expense.

#### **Note 8: Stockholders' Equity**

During the nine months ended March 31, 2009, the Company did not issue any shares of its common or any options and warrants to purchase shares of common stock.

The Company has issued shares of its common stock as collateral for certain notes payable to related parties. These collateral shares are restricted and bear a legend prohibiting the holder from selling or transferring the shares at any time. The Company has assigned no value to these shares, and the terms of the notes payable require the holder of the collateral shares to return the shares to the Company when the applicable note and accrued interest are paid in full. As of March 31, 2009, Company had issued 5,350,000 shares of common stock as collateral.

### **Note 9: DARPA Contract**

In January 2009, DARPA awarded the Heliplane prime contractor position to the Georgia Institute of Technology (GT) for Phase IB of the DARPA contract and the Company was engaged as a GT subcontractor for rotor systems work. As of the date of this Report, Phase IB of the DARPA contract had been completed

### **Note 10: Supplemental Statement of Cash Flows Information**

During the nine months ended March 31, 2009 the Company had the following non-cash investing and financing activities:

- Decreased related party notes receivable through reduction of accrued expenses payable to related parties of \$1,000.
- Decreased property and equipment and decreased accounts payable by \$19,000 for property and equipment returned to vendor.
- Decreased accrued expenses and increased common stock by \$7,000 for changes to accrued finders' compensation.
- Increased related party notes payable and decreased Series B Preferred Stock by \$36,962,000 upon partial redemption of Series B Preferred Stock.
- Increased related party notes payable and decreased accounts payable by \$867,000.

During the nine months ended March 31, 2008 the Company had the following non-cash investing and financing activities:

- Decreased related party notes receivable through reduction of accrued expenses payable to related parties of \$8,000.
- Increased property and equipment and decreased inventories by \$14,000 for work-in progress inventories transferred to construction-in-progress.
- Acquired property and equipment through the issuance of accounts payable of \$230,000.
- Acquired property and equipment through the issuance of related party notes payable of \$5,000.
- Issued shares of common stock in payment of employer 401(k) match of \$306,000.
- Issued 15,000 shares of common stock in payment of accrued expenses of \$16,000.
- Decreased accrued expenses and increased common stock by \$17,000 for changes to accrued finders' compensation.
- Decreased accrued expenses and increased debt by \$579,000 for accrued interest payable added to debt principal.

Cash paid for interest expense was \$35,000 and \$776,000 for the nine months ended March 31, 2009 and 2008, respectively.

No payments of income taxes were made during the nine months ended March 31, 2009 and 2008.

#### **Note 11: Recently Issued Accounting Pronouncements**

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles – a Replacement of FASB Statement No. 162*. The Codification will become the source of authoritative U.S. generally accounting principles (GAAP) recognized by the FASB to be applied to nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009 (our quarter ended September 30, 2009). We are currently unable to determine what impact the future application of this pronouncement may have on our consolidated financial statements.

On May 28, 2009, the FASB issued SFAS No. 165, *Subsequent Events*. This statement is intended to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date—that is, whether that date represents the date the financial statements were issued or were available to be issued. This disclosure is intended to alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. The statement is effective for interim and annual periods ending after June 15, 2009, or our fiscal year ended June 30, 2009. We are currently unable to determine what impact the future application of this pronouncement may have on our consolidated financial statements.

#### **Note 12: Subsequent Events**

**Series B Preferred Stock** – Subsequent to March 31, 2009, the redemption date of the Series B Preferred Stock has been extended from time to time and currently is May 9, 2010, or such later date as agreed to in writing by the holders of at least 80% of the outstanding shares of Series B Preferred Stock.

Subsequent to the end of January, 2009, the lenders and the Company have amended the October 9, 2008 Note Purchase Agreement from time to time to increase the aggregate amount of promissory notes that can be purchased to \$5,750,000 to provide funding to meet the Company's monthly minimum financial needs. The lenders are not obligated to purchase notes pursuant to the Note Purchase Agreement and there can be no assurance that the lenders will continue to purchase notes or otherwise provide funding to the Company.

#### **Debt Financing**

Subsequent to March 31, 2009 through April 19, 2010, the Company has received net proceeds from debt financing of approximately \$2.8 million, substantially all of which was funding received pursuant to the Note Purchase Agreement.

The maturity date for the 2006/2007 Notes, the Dividend Notes and the Note Purchase Notes has been extended from time to time and currently is May 9, 2010.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Forward Looking Statements**

*This management's discussion and analysis of financial condition and results of operations and other portions of this Quarterly Report on Form 10-Q contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by this forward-looking information. Factors that could cause or contribute to such differences include, but are not limited to, those discussed or referred to in the Annual Report on Form 10-K for the year ended June 30, 2008, filed on November 12, 2009, under the heading "Forward Looking Statements" and elsewhere. Investors should review this quarterly report on Form 10-Q in combination with our Annual Report on Form 10-K in order to have a more complete understanding of the principal risks associated with an investment in our common stock. This management's discussion and analysis of financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included elsewhere in this document.*

### **Late Filing**

This Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2009 is first being filed in April 2010. The Company is in the process of preparing its other periodic reports, including the Form 10-K for the fiscal year ended June 30, 2009, and plans to file such reports at the earliest practicable date. Shareholders and others are cautioned that the financial statements included in this report are over one year old and are not necessarily indicative of the operating results that may be expected for the years ending June 30, 2009 or 2010.

### **Background**

We are engaged in the business of designing and developing new technology gyroplane and gyrodyne rotor-wing aircraft for military and commercial uses. Following the delays in our Heliplane program for DARPA, lower than anticipated results from sales of SparrowHawk kits, and negative conditions in capital markets, we undertook cost-cutting measures that we hope will allow us to continue to develop our technology on a reduced scale. We effected a substantial reduction in force and have reduced other operating expenditures as well.

### **Significant Series B Preferred Stock and Debt Obligations**

From 2006 through the present, in addition to other debt, the Company has obtained debt and equity financing from certain lenders who are also stockholders of the Company. As of March 31, 2009, the Company's obligations to such lenders included: 36% promissory notes issued during 2006 and 2007 in the aggregate principal amount of \$4,400,000 (the "2006/2007 Notes"); a \$36,411,000 Series B 15% Cumulative Preferred Stock Obligation; 15% secured promissory notes in the aggregate principal amount of \$39,670,000 that were issued in satisfaction of accrued dividends of \$36,962,000 on the Series B Preferred Stock through October 9, 2008 plus \$2,708,000 in interest accrued and added to debt principal through March 31, 2009 (the "Dividend Notes"); and secured 15% promissory notes in the aggregate principal amount of \$1,935,000 issued pursuant to the Note Purchase Agreement dated October 9, 2008 (the "Note Purchase Notes"). As discussed in more detail below, the redemption date of the Series B Preferred Stock and the maturity dates of the 2006/2007 Notes, the Dividend Notes and the Note Purchase Notes have been extended to May 9, 2010. The Company is generating limited revenues which are not adequate to pay the interest accruing on the debt described above and the Company will be unable to repay such debt when it becomes due on May 9, 2010. Substantially all the Company's assets have been pledged to secure its debts and if the lenders should fail to further extend the redemption dates and maturity dates for such debts as they have done in the past, such lenders could foreclose on substantially all the assets of the Company and the Company would be forced to discontinue its operations. No

assurances can be given that the lenders will further extend the redemption and maturity dates for such preferred stock and debt obligations or that if extended, the Company will be able to generate revenue or other sources of funds in the significant amount required in order to service and ultimately repay such debt.

### **Going Concern Uncertainty**

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Because of recurring operating losses, the excess of current liabilities over current assets, the stockholders' deficit, and negative cash flows from operations, there is substantial doubt about the Company's ability to continue as a going concern.

At March 31, 2009, the Company had total current liabilities of \$111,363,000 and current assets of \$224,000, resulting in a working capital deficiency of \$111,139,000. At March 31, 2009, the Company had a total stockholders' deficit of \$118,363,000.

Following delays in our Heliplane program for the U.S. Defense Advanced Research Projects Agency ("DARPA"), lower than anticipated results from sales of our SparrowHawk kits, and negative conditions in capital markets, we effected a substantial reduction in force and have significantly scaled back the level of our operations.

Historically, the Company experienced a negative gross profit on sales of Sparrow Hawk kits and the number of SparrowHawk kits sold fell below expectations, due in part to lack of funding to finalize product development and to pay for increased sales and marketing efforts. In these circumstances, prospects of reaching a satisfactory profit level in a deteriorating economic climate were not promising. As importantly, the Company determined that the kit aircraft business, aimed at customers for their personal use could not be readily compatible with the design, manufacture and marketing of more sophisticated aircraft required by military and commercial customers. Therefore, in May 2008, the Company decided to cease production of the SparrowHawk and to seek to sell the program to a buyer with more compatible operating conditions and strategic interests. Consistent with this decision, and as part of its reduction in operations, the Company discontinued its SparrowHawk flight training and other flight operations at Buckeye Airport, Arizona and also terminated the lease on its primary hangar at that location. The Company retained its small leased hangar at Buckeye for storage and to maintain the ability to undertake flight tests or demonstration flights at that airport if needed.

The Company has also experienced a negative profit margin on the DARPA contract, which has reduced cash flows from operations. Subsequent to March 31, 2009, DARPA announced the award of the Heliplane prime contractor position to the Georgia Institute of Technology (GT) for Phase IB. Since then, the Company has been engaged as a GT subcontractor for rotor systems work of Phase IB.

The Company's continuation as a going concern is dependent on attaining profitable operations, obtaining additional outside financing and/or restructuring its debt obligations, including its Series B Preferred Stock. The Company has funded losses from operations primarily from the issuance of debt to related parties (current shareholders and lenders of the Company), the increase in accounts payable and accrued expenses, and the sale of the Company's restricted common stock in private placement transactions, and will require additional funding from these sources to sustain its future operations.

In order to repay its debt obligations in full or in part when due, the Company will be required to raise significant capital from other sources. Alternatively, the Company will be required to negotiate further extensions of the Series B Preferred Stock maturity date and its notes payable, as it has accomplished in the past. There is no assurance, however, that the Company will be successful in these efforts.

During 2006 and 2007, the Company obtained debt financing from the Series B Holders in exchange for 2006/2007 Notes in the aggregate principal amount of \$4,400,000. The 2006/2007 Notes provide for the payment of simple interest at the rate of 36% per annum. The maturity date for the 2006/2007 Notes has been extended from time to time and currently is May 9, 2010.

Included in current liabilities and the working capital deficiency at March 31, 2009 is a \$36,411,000 Series B Preferred Stock obligation. The Series B Holders have agreed to extend the redemption date of the Series B Preferred Stock from time to time and the current redemption date is May 9, 2010, or such later date as agreed to in writing by at least 80% of the Series B Holders.

In October 2008, as part of a Note Purchase Agreement between the Company and the Series B Holders, the Company issued short-term interest bearing Dividend Notes in the principal amount of \$36,962,000 in satisfaction of the accrued and unpaid dividends on the Series B Preferred Stock through October 9, 2008. Because the Company had paid such dividends in kind by issuing additional shares of Series B Preferred Stock, the issuance of the Dividend Notes resulted in the redemption of \$36,962,000 of Series B Preferred Stock. The Dividend Notes provide for the payment of interest at the rate of 15% per annum, compounded quarterly. The maturity date for the Dividend Notes has been extended from time to time and currently is May 9, 2010.

The Note Purchase Agreement, as amended, provides for the periodic sale by the Company to the lenders of short-term Note Purchase Notes in the aggregate principal amount of up to \$5,750,000 to provide the Company with operating capital, as specified in the draw requests for such notes. The draw requests must be approved by the lenders. Through March 31, 2009, the lenders had purchased notes under the Note Purchase Agreement in the aggregate principal amount of \$1,935,000 and the proceeds had been used by the Company to cover its minimum cash needs in excess of funding provided by payments from Georgia Tech for the Company's work on the DARPA contract. The Note Purchase Notes provide for the payment of simple interest at the rate of 15% per annum. The maturity date of the Note Purchase Notes has been extended from time to time and currently is May 9, 2010.

Substantially all assets of the Company, including its intellectual property, have been pledged as collateral for the Company's debt.

There can be no guarantee or assurance that the Company will be successful in its ability to generate income from operations or from the DARPA contract, or to raise capital at favorable rates or at all. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### **DARPA Contract**

On November 7, 2005, DARPA selected a Company-led team to design a proof of concept high-speed, long range, VTOL aircraft. This modern rotorcraft, named the "Heliplane" by DARPA, is intended as a demonstrator aircraft for potential use in combat search and rescue roles and is designed to fly at a forward speed of 400 mph which is a speed twice as fast as is typical for helicopters, with a 1,150 mile range, essentially offering the VTOL capability of a helicopter with the fast forward flight capability of an airplane with the safety, simplicity and reliability of a GBA gyroplane and is designed to exploit our gyrodyne technology.

Phase One of this potential multi-year four-phase Heliplane program began with a 15-month \$6.4 million award to develop the preliminary design and perform key technology demonstrations. On September 19, 2007, the DARPA contract was modified, increasing the contract award from \$6.4 million to \$10.4 million, and extending the term of Phase One from 15 to 23 months. Substantial portions of Phase One payments were paid by us to subcontractors and consultants hired by us. Payments under this

contract were conditional upon our attaining several milestone objectives during the course of Phase One of the contract.

We completed Phase One of the four phase program with a preliminary design review (PDR) in November of 2007. In January of 2009, DARPA funded a six month Heliplane Phase 1B effort to design and evaluate a modification to the Heliplane's rotor-blade tip-jets to reduce its sound signature. For Phase 1B, DARPA chose, at our recommendation, Georgia Tech to lead the program as prime contractor with the Company as the primary subcontractor for the critical rotor system. We made this recommendation because of our inability to fund the cash flow shortfall while waiting to be paid for work completed. Phase 1B had been completed as of the date of this report, and we do not know whether Phase 2 will be awarded.

### **Future Company Gyrodyne and Gyroplane Aircraft**

The Heliplane gyrodyne represents the possible model for the next generation rotor wing aircraft, meeting economy and performance goals not considered achievable by any other type of VTOL aircraft. As our gyrodyne technology is scalable to much larger aircraft, it has potential applications for both heavy lift, high speed short-range vertical take-off and landing ("VTOL") military aircraft and for runway independent commercial airliners. We have been actively engaged in discussions with government agencies and potential aerospace strategic partners in this country with respect to military and commercial gyrodyne and gyroplane applications, and in Europe, India, Korea and China with respect to commercial gyroplane applications.

The gyrodyne technology developed for the Heliplane also has direct application to the design of short-range VTOL commercial airliners that are runway independent. We believe that growth in the economy can produce heavy demand for aircraft that do not require the use of increasingly congested runways and are not limited by air traffic control constraints, and we anticipate an opportunity to develop such an aircraft. We believe that by using the airframe of an existing type-certificated production airplane and adding our rotor system, gyrodyne airliners can be delivered for substantially less investment and in less time than would normally be required to bring a new airliner to market. Our longer-range plans have identified opportunities for large (18-60 seat) gyrodynes to provide commercial passenger service in short and medium-range markets.

We believe the proposals that we have presented, or participated in presenting, have been well received and helped generate credibility for the value of our technology among key segments of the aerospace industry. We will continue to seek opportunities to obtain government research and development contracts for use of our technology in both military and civilian agency fields where we believe that it can offer meaningful advantages in performance or cost over competing technologies. Management believes that it is in the national interest that our unique gyroplane technology is developed.

Executive officers and employees of the Company have met in China with government officials and aerospace executives on several occasions and Company representatives have made presentations covering the application of our gyroplane and gyrodyne technologies to China's commercial needs. The presentations were well received and resulted in us being invited back to China to discuss specific proposals for joint ventures or cooperation. We continue to make progress with the objective of setting up a JV partner to produce fully-assembled SparrowHawks in China. We have also been introduced to a potential Light Gyroplane JV partner and we continue to make progress with that objective.

We believe that Asia represents a potentially very large market for our products, from the SparrowHawk size gyroplanes, to the Hawk 4 gyroplane and its variants, to the varying sizes of tip-jet powered gyrodynes in commuter airline and transport category aircraft. In addition, we believe that these types of safe, economical, high performance Ultra-Short and Vertical Takeoff and Landing (USTOL and VTOL) aircraft can be very important in helping solve the transportation needs of the burgeoning

economies of China, India, Korea and other Asian nations. However, we have not entered into any definitive agreements or arrangements for the development or sale of our products in Asia and no assurances can be given that we will be able to complete development of such products or be able to sell such products in Asia.

All our government marketing and therefore our responses to requests for proposals to participate in research and development programs suited to our technology have been directed exclusively to the United States Government.

## Results of Operations

### Revenues

The Company's consolidated revenues are comprised of the following:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Government contract	\$ 467,000	\$ 1,972,000	\$ 830,000	\$ 5,070,000
Commercial subcontract	-	-	-	26,000
SparrowHawk kits and parts	2,000	208,000	19,000	612,000
Flight training	-	9,000	1,000	33,000
Other operating	-	25,000	3,000	42,000
Total	<u>\$ 469,000</u>	<u>\$ 2,214,000</u>	<u>\$ 853,000</u>	<u>\$ 5,783,000</u>

Total revenues decreased \$1,745,000 to \$469,000 in the three months ended March 31, 2009 from \$2,214,000 in the three months ended March 31, 2008 and decreased \$4,930,000 to \$853,000 in the nine months ended March 31, 2009 from \$5,783,000 in the nine months ended March 31, 2008. The decrease in revenues in the current fiscal year was attributed to the decrease in all revenue sources, including the DARPA contract, sales of SparrowHawk kits and parts, flight training and other operating revenues. As discussed above, we significantly scaled back the level of our operations in the fiscal year ended June 30, 2008, including ceasing production of the SparrowHawk, eliminating substantially all flight training and reducing the level of our involvement in the DARPA contract.

We recognize revenue on the DARPA contract as each defined milestone is completed and the requisite meetings are held and technical data submitted and accepted by DARPA. At that time, DARPA instructs us to submit an invoice for payment for the respective milestone at the amount specified in the contract.

## Costs and Expenses

The Company's consolidated cost of sales is comprised of the following:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2009	2008	2009	2008
Government contract	\$ 226,000	\$ 1,434,000	\$ 644,000	\$ 4,524,000
Commercial subcontract	-	-	-	73,000
SparrowHawk kits and parts	1,000	569,000	-	1,605,000
Flight training	-	2,000	-	9,000
Total	\$ 227,000	\$ 2,005,000	\$ 644,000	\$ 6,211,000

Total cost of sales decreased \$1,778,000 to \$227,000 in the three months ended March 31, 2009 from \$2,005,000 in the three months ended March 31, 2008 and decreased \$5,567,000 to \$644,000 in the nine months ended March 31, 2009 from \$6,211,000 in the nine months ended March 31, 2008. As discussed above, we have significantly scaled back the level of our operations in the current fiscal year, including ceasing production of the SparrowHawk, eliminating flight training and reducing the level of our involvement in the DARPA contract.

Subsequent to March 31, 2009, DARPA announced the award of the Heliplane prime contractor position to the Georgia Institute of Technology (GT) for Phase IB. Since then, we have been engaged as a GT subcontractor for rotor systems work of Phase IB. Payments to us by GT are expected to be paid on a monthly basis, significantly reducing our cash flow risk from the Heliplane program.

Research and development expenses for the three months ended March 31, 2009 increased to \$81,000 from \$70,000 for the three months ended March 31, 2008. However, research and development expenses decreased to \$246,000 for the nine months ended March 31, 2009 from \$746,000 for the nine months ended March 31, 2008 as a result of the reduction in our level of operations. Research and development activities include the development of opportunities for subcontract opportunities with industry partners, variations to the SparrowHawk, fully assembled SparrowHawk gyroplane derivatives, potential applications of our technology to heavy lift vertical take-off military aircraft, runway independent short-haul airliners and other aircraft, including government contract opportunities.

As a result of the reduction in our level of operations, general and administrative expenses for the three months ended March 31, 2009 decreased to \$238,000 from \$889,000 for the three months ended March 31, 2008 and decreased to \$693,000 for the nine months ended March 31, 2009 from \$2,450,000 for the nine months ended March 31, 2008.

## Other Income and Expenses

As a result of the reduction in our related party notes receivable, related party interest income is currently insignificant to our consolidated financial statements. Related party interest income was \$1,000 and \$2,000 for the three months and nine months ended March 31, 2009, respectively, compared to \$1,000 and \$3,000 for the three months and nine months ended March 31, 2008, respectively.

Interest and other income decreased to \$0 in the three months ended March 31, 2009 from \$18,000 in the three months ended March 31, 2008 and decreased to \$1,000 in the nine months ended March 31, 2009 from \$24,000 in the nine months ended March 31, 2008. Interest and other income is also currently insignificant to our consolidated financial statements, with the decrease in reported amounts resulting from the reduction in our level of operations and continued low levels of interest bearing cash.

We realized a gain on the sale of property and equipment of \$45,000 in the nine months ended March 31, 2009. We did not have any sales of property and equipment in the nine months ended March 31, 2008.

We realized a gain on extinguishment of debt of \$23,000 in the three months ended March 31, 2008 and \$47,000 for the nine months ended March 31, 2008. We had no gain on extinguishment of debt during the three months and nine months ended March 31, 2009.

Interest expense for the three months ended March 31, 2009 increased to \$2,453,000 from \$1,131,000 for the three months ended March 31, 2008 and increased to \$5,721,000 for the nine months ended March 31, 2009 from \$2,964,000 for the nine months ended March 31, 2008. We had a net increase in cash borrowings of \$1,917,000 in the nine months ended March 31, 2009. In addition, in October 2008, we increased our interest-bearing debt by \$36,962,000 through a partial redemption of our Series B Preferred Stock. However, the increase in interest expense in the current fiscal year was partially offset by additional interest expense that was incurred in the prior fiscal year for the value of stock and stock options issued to lenders in connection with new debt or debt extensions. No stock or stock options were issued in the current fiscal year.

Series B Preferred Stock interest expense for the three months ended March 31, 2009 decreased to \$1,316,000 from \$2,373,000 for the three months ended March 31, 2008 and decreased to \$5,278,000 for the nine months ended March 31, 2009 from \$6,863,000 for the nine months ended March 31, 2008. This decrease is attributed to the \$36,962,000 redemption of Series B Preferred Stock for the Dividend Notes in October 2008. Dividends on the Series B Preferred Stock, which are recorded as interest expense, have been “paid in kind” with additional shares of Series B Preferred Stock.

### **Net Loss**

For the three months ended March 31, 2009, the loss from operations was \$77,000 compared to the loss from operations of \$750,000 for the three months ended March 31, 2008. For the nine months ended March 31, 2009, the loss from operations was \$730,000 compared to the loss from operations of \$3,624,000 for the nine months ended March 31, 2008. The decrease in the loss from operations in the current fiscal year resulted primarily from the reduced level of our operations as discussed above.

The net loss for the three months ended March 31, 2009 was \$3,845,000 compared to \$4,212,000 for the three months ended March 31, 2008. The net loss for the nine months ended March 31, 2009 was \$11,681,000 compared to \$13,377,000 for the nine months ended March 31, 2008. The decrease in the net loss in the current fiscal year resulted primarily from the decrease in loss from operations, partially offset by an increase in interest expense.

### **Liquidity and Capital Resources**

#### **Series B Preferred Stock Obligation**

At March 31, 2009, we had total current liabilities of \$111,363,000 and current assets of \$224,000, resulting in a working capital deficiency of \$111,139,000. Included in current liabilities and the working capital deficiency at March 31, 2009 is a \$36,411,000 Series B Preferred Stock obligation. On May 10, 2007, we received the approval of the Series B Holders to extend the redemption date of the Series B Preferred Stock from May 1, 2007 to June 16, 2007, or such later date as agreed to in writing by at least 80% of the Series B Holders. Subsequently, the Series B Holders agreed in writing to an extension of the redemption date from June 16, 2007, to June 30, 2008.

During 2006 and 2007, the Company obtained debt financing from the Series B Holders in exchange for 2006/2007 Notes in the aggregate principal amount of \$4,400,000. The 2006/2007 Notes provide for the payment of simple interest at the rate of 36% per annum. The maturity date of the 2006/2007 Notes has been extended from time to time and currently is May 9, 2010.

In October 2008, as part of a Note Purchase Agreement between the Company and the Series B Holders, we redeemed \$36,962,000 of the outstanding Series B Stock in exchange for short-term interest bearing Dividend Notes, and the Series B Holders agreed to an extension of the redemption date of the remaining Series B Stock from June 30, 2008 to April 9, 2009. Subsequently, the redemption date has been extended from time to time and currently is May 9, 2010, or such later date as agreed to in writing by the holders of at least 80% of the outstanding shares of Series B Preferred Stock. The Dividend Notes provide for the payment of interest at the rate of 15% per annum, compounded quarterly. The maturity date of the Dividend Notes has also been extended from time to time and currently is May 9, 2010.

In addition, the Note Purchase Agreement, as amended, provides for the periodic sale by the Company to the lenders of short-term Note Purchase Notes to provide the Company with operating capital, as specified in the draw requests for such notes. The draw requests must be approved by the lenders. Through March 31, 2009, the lenders had purchased notes under the Note Purchase Agreement in the aggregate principal amount of \$1,935,000 and the proceeds had been used by us to cover our minimum cash needs in excess of funding provided by payments from Georgia Tech for our work on the DARPA contract. The Note Purchase Notes provide for the payment of simple interest at the rate of 15% per annum. The maturity date of the Note Purchase Notes has been extended from time to time and currently is May 9, 2010.

The lenders and the Company have amended the October 9, 2008 Note Purchase Agreement from time to time to increase the aggregate amount of promissory notes than can be purchased to \$5,750,000 to provide funding to meet our monthly minimum financial needs. The lenders are not obligated to purchase notes pursuant to the Note Purchase Agreement and there can be no assurance that the lenders will continue to purchase notes or otherwise provide funding to the Company.

Subsequent to March 31, 2009 through April 5, 2010, the Company has received net proceeds from debt financing of approximately \$2.0 million, substantially all of which was funding received pursuant to the Note Purchase Agreement.

In connection with the execution of the Note Purchase Agreement and the issuance of the Series B Preferred Stock, substantially all our assets, including our intellectual property, have been pledged as collateral for our debt.

In order to repay these obligations in full or in part when due, we will be required to raise significant capital from other sources and to meet certain capital requirements under Utah State law. Alternatively, we will be required to negotiate another extension of the Series B Preferred Stock redemption date and the maturity dates of the 2006/2007 Notes, the Dividend Notes and the Stock Purchase Notes, as we have accomplished in the past. There is no assurance, however, that we will be successful in raising the capital required to repay the Series B Preferred Stock and related notes payable obligations or in obtaining a further extension of the Series B Preferred Stock redemption date and the related notes payable maturity dates beyond May 9, 2010.

### **Other Debt Obligations**

Current liabilities at March 31, 2009 also included \$59,278,000 notes payable to related parties, including the following:

Series B Holders:	
Dividend Notes	\$39,670,000
Note Purchase Notes	1,935,000
2006/2007 Notes	4,400,000
	<hr/>
	46,005,000
Other Related Parties	13,273,000
	<hr/>
Total Related Party Notes Payable	<u>\$59,278,000</u>

Of the other related parties notes, \$6,207,000 is in default. In addition, we are delinquent in making payments of accrued interest payable of \$3,755,000 on this related party debt at March 31, 2009. Most of these related party notes payable are held by long-time shareholders and lenders of the Company and are payable on demand or are short-term in nature. There is no assurance that these related party lenders will not demand payment of this short-term indebtedness in the near future.

Also included in current liabilities at March 31, 2009 are notes payable to unrelated parties of \$523,000, substantially all of which is in default. In addition, we are delinquent in making payments of accrued interest payable of \$639,000 on this debt at March 31, 2009. We continue to make some payments on this indebtedness and continue discussions with many of these vendors and lenders, and have, in most instances, been granted grace periods and extensions without receipt of formal notices of default or threat of legal action. There is no assurance that these vendors and lenders will continue to forebear from collection or legal action.

### **Operating, Investing and Financing Activities**

As discussed above, we have substantially reduced the level of our operations. Therefore, the amounts of cash provided by or used in operating, investing and financing activities for the nine months ended March 31, 2009 are generally less than the amounts reported for the nine months ended March 31, 2008.

Net cash used in operating activities was \$1,691,000 for the nine months ended March 31, 2009 compared to \$3,074,000 for the nine months ended March 31, 2008. The net cash used in operating activities decreased in the current fiscal year primarily because of a lower net loss further reduced by interest expense accrued on Series B preferred stock, interest expense added to debt principal and an increase in accrued expenses.

Net cash provided by investing activities for the nine months ended March 31, 2009 was \$29,000, consisting of proceeds from the sale of property and equipment of \$27,000 and payments of related party notes receivable of \$2,000. Net cash used in investing activities for the nine months ended March 31, 2008 was \$4,000 comprised of the purchase of property and equipment of \$6,000, partially offset by related party notes receivable repayments received of \$2,000.

We have funded losses from operations and net cash used in investing activities in the current fiscal year primarily from the issuance of debt to related parties (current shareholders and lenders of the Company), the increase in accrued expenses, and will require additional funding from these sources to sustain our future operations.

Net cash provided by financing activities was \$1,848,000 for the nine months ended March 31, 2009, comprised of a net increase in debt of \$1,917,000, partially offset by a repayment of bank overdraft of \$22,000 and repayment of bank overdraft line of credit of \$47,000. Net cash provided by financing activities for the nine months ended March 31, 2008 was \$3,018,000, comprised of a net increase in debt

of \$2,887,000 and net proceeds from the issuance of common stock of \$132,000, partially offset by the payment of finders' compensation of \$1,000.

We currently do not have sufficient cash to sustain our operations for the next twelve months. We are dependent on the lenders under the Note Purchase Agreement to continue to fund operating losses in the short-term, or until revenues grow to the point where they are sufficient to cover operating costs and expenses. As discussed above, the Note Purchase Agreement provides for the periodic sale by the Company to the lenders of short-term promissory notes to provide the Company with operating capital, as specified in the draw requests for such notes. The draw requests must be approved by the lenders. Through March 31, 2009, the lenders had purchased notes under the Note Purchase Agreement in the aggregate principal amount of \$1,935,000 and the proceeds had been used by us to cover our minimum cash needs in excess of funding provided by payments from Georgia Tech for our work on the DARPA contract, funding that was completed in September 2009. There is no assurance that this funding under the Note Purchase Agreement will continue beyond the current short-term agreement, and there is no assurance that we will be successful in either raising sufficient capital from other sources or improving operations.

Management does not anticipate that revenues or expenses will be materially affected by inflation during the next twelve months of operations.

Our operations are not subject to material seasonal fluctuations.

#### **Off Balance Sheet Commitments**

We lease facilities under non-cancelable operating leases. Future minimum rental payments required under these leases are as follows:

<u>Years Ending June 30,</u>	<u>Amount</u>
2009	\$ 258,000
2010	271,000
2011	<u>73,000</u>
	<u>\$ 602,000</u>

#### **Critical Accounting Policies**

Our critical accounting policies include the following:

**Impairment of Long-Lived Assets** - We periodically review our long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We evaluate, at each balance sheet date, whether events and circumstances have occurred which indicate possible impairment. The carrying value of a long-lived asset is considered impaired when the anticipated cumulative undiscounted cash flows of the related asset or group of assets is less than the carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the estimated fair market value of the long-lived asset.

**Research and Development Costs** - Research and development costs are expensed as incurred in accordance with SFAS No. 2, "Accounting for Research and Development Costs." The costs of materials and other costs acquired for research and development activities are charged to expense as incurred. Salaries, wages, and other related costs of personnel, as well as other facility operating costs are allocated

to research and development expense through management's estimate of the percentage of time spent by personnel in research and development activities.

**Revenue Recognition** - We recognize revenues from goods and services when there is a binding agreement, the product has been completely shipped or service has been delivered, collection is reasonably assured, and we have no significant obligations remaining. Portions of the purchase price of our products collected from customers in advance of product delivery are recorded as deferred revenue. Therefore, revenues from the sale of SparrowHawk gyroplane kits are not recorded until all kit components and parts are delivered to the customer and collection of any remaining amounts due is reasonably assured.

We recognize revenue on our current government contract as each defined milestone is completed and the requisite meetings are held and technical data submitted and accepted by DARPA. At that time, DARPA instructs us to submit an invoice for payment for the respective milestone at the amount specified in the contract. Contract-related expenses incurred by us for each milestone of the contract, including its own labor, travel, supplies and other costs, and the costs of subcontractors and consultants, are deferred as work-in-process inventory and expensed to cost of sales as the contract revenue for the milestone is recognized. When a loss on a contract is projected, however, all contract-related costs and expenses are expensed as incurred.

We recognize revenue on commercial and sub-contractor contracts as each scheduled phase of the contract is completed and invoices are submitted. Contract-related expenses incurred by us for each phase of the contract, including its own labor, travel, supplies and other costs, and the costs of subcontractors and consultants, are deferred as work-in-process inventory and expensed to cost of sales as the contract revenue for the milestone is recognized. When a loss on a contract is projected, however, all contract-related costs and expenses are expensed as incurred.

**Stock-Based Compensation** – We have adopted the fair value recognition provisions of SFAS No. 123(R), *Share Based Payments*, which requires us to measure the compensation cost of stock options and other stock-based awards to employees and directors at fair value at the grant date and recognize compensation expense over the requisite service period for awards expected to vest. The grant-date fair value of stock options and other stock-based awards is estimated using the Black-Scholes option-pricing model. The stock-based compensation expense has been allocated to the various categories of costs and expenses in a manner similar to the allocation of payroll expense. Changes in the assumptions used in the option-pricing model, including the market price of the Company's common stock, risk-free interest rates, estimated forfeitures and life of the options, may result in fluctuations in the estimated fair value and carrying value of the consideration recorded for employee stock options.

**Non-Employee Stock Options and Warrants** – In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation", we estimate the fair value of the consideration recorded for stock options and warrants issued to non-employees using the Black-Scholes option-pricing model. For those stock options and warrants that have variable characteristics, we will continue to use this methodology to periodically reassess the fair value of the consideration to determine if the value of the consideration recorded in the consolidated financial statements requires adjustment. Changes in the assumptions used in the option-pricing model, including the market price of our common stock and risk-free interest rates, may result in fluctuations in the estimated fair value and carrying value of the consideration recorded for variable non-employee stock options and warrants.

**Financial Instruments with Characteristics of Both Liabilities and Equity** - In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity." This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of

those instruments were previously classified as equity. The statement was effective on July 1, 2003 for financial instruments entered into or modified after May 31, 2003, and otherwise effective for existing financial instruments entered into before May 31, 2003. The adoption of SFAS No. 150 resulted in the reporting of our Series B Preferred Stock as a liability. The carrying value of the Series B Preferred Stock was the same before and after adoption of SFAS No. 150, and therefore no cumulative effect adjustment was required.

**Income Taxes** - We account for income taxes according to the asset and liability method. The asset and liability method requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between tax bases and financial reporting bases of existing assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

### **Recently Issued Accounting Pronouncements**

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles – a Replacement of FASB Statement No. 162*. The Codification will become the source of authoritative U.S. generally accounting principles (GAAP) recognized by the FASB to be applied to nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009 (our quarter ended September 30, 2009). We are currently unable to determine what impact the future application of this pronouncement may have on our consolidated financial statements.

On May 28, 2009, the FASB issued SFAS No. 165, *Subsequent Events*. This statement is intended to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date—that is, whether that date represents the date the financial statements were issued or were available to be issued. This disclosure is intended to alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. The statement is effective for interim and annual periods ending after June 15, 2009, or our fiscal year ended June 30, 2009. We are currently unable to determine what impact the future application of this pronouncement may have on our consolidated financial statements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Because the Company is a Smaller Reporting Company, it is not required to respond to this Item.

## **Item 4T. Controls and Procedures**

### *Evaluation of Disclosure Controls and Procedures*

Our management, under the supervision and with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2009, the end of the period covered by this report. Based on that evaluation, and as further discussed below, our chief executive officer and chief financial officer concluded that the disclosure controls and procedures employed at the Company as of March 31, 2009 were not effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined under Exchange Act Rules 13a-15(f). Our internal control system is designed to provide reasonable assurance to our management and board of directors regarding the preparation and fair presentation of published financial statements. As provided in Item 9A(T) of our 2008 annual report on Form 10-K, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an annual evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under that framework, management concluded that our internal control over financial reporting was not effective as of June 30, 2008.

As a result of our decision to cease production of the SparrowHawk, our reduced involvement in the DARPA contract, and the resulting substantial decrease in our operations, we eliminated substantially all full time accounting and finance personnel. We have not, therefore, timely prepared our consolidated financial statements and filed our periodic reports with the SEC. We currently utilize primarily former employees, working either as part time employees or outside consultants, to maintain the financial records of the Company and to prepare the consolidated financial statements and footnote disclosures of the Company. This has resulted in less segregation of accounting duties and less compliance with financial close procedures than had previously been implemented when a fully staffed accounting and finance department was in place. This lack of internal oversight and review resulted in adjusting journal entries not detected by us that were material to our consolidated financial statements. In addition, the Audit Committee of our Board of Directors is currently comprised of two individuals who are not independent directors.

We concluded that these deficiencies in the design and operation of our internal control over financial reporting may be considered material weaknesses. A material weakness is a control deficiency (within the meaning of the Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 2) or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected. In light of the material weaknesses described above, we performed additional analyses and other post-closing procedures and increased the involvement of outside consultants to ensure our financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, we believe that the consolidated financial statements included in this report fairly present, in all material respects, our financial condition, results of operations and cash flows for the periods presented. We intend to continue the involvement of outside consultants and further implement additional analyses and financial close procedures to ensure that our financial statements are timely prepared in accordance with generally accepted accounting procedures.

### ***Change in Internal Control Over Financial Reporting***

Other than those matters discussed above, there was no change in our internal control over financial reporting during the third quarter of our fiscal year 2009, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We are not involved in any material pending legal proceedings other than ordinary routine litigation incidental to our business and, to the best of our knowledge, no material legal proceedings against the Company have been threatened. We are subject to the potential of various claims and legal actions arising in the ordinary course of business, including certain matters relating to past due amounts to creditors. The past due amounts are recorded as liabilities in our consolidated financial statements, and management believes that the amount, if any, that may result from other claims will not have a material adverse effect on our consolidated financial statements.

### **Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Item 1A – “Risk Factors” in our Annual Report on Form 10-K for the year ended June 30, 2008, which could materially affect our business, financial condition or future results of operations.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

There were no sales of unregistered equity securities during the three months ended March 31, 2009.

### **Item 3. Defaults Upon Senior Securities**

As more fully discussed under “Liquidity and Capital Resources” above, the Company is delinquent in making payments on notes payable to vendors and others totaling \$523,000, notes payable to related parties totaling \$6,207,000, and \$4,394,000 of accrued interest payable on debt.

### **Item 4. Submission of Matters to a Vote of Security Holders**

There were no matters submitted to a vote of security holders during the three months ended March 31, 2009.

## **Item 5. Other Information**

### **Amendments to Note Purchase Agreement**

The Note Purchase Agreement dated as of October 9, 2008 among the Company and the lenders named on the signature page thereto (the “Lenders”) has been amended from time to time to increase the aggregate principal amount of the promissory notes that could be purchased under the agreement to \$5,750,000.

In connection with the Note Purchase Agreement, the Company entered into a Security Agreement and Intellectual Property Security Agreements with the Lenders which were amended and restated on January 20, 2009 and October 9, 2008, respectively, pursuant to which the Company and its subsidiaries granted the Lenders security interests in all the assets of the Company, real and personal, tangible and intangible, specifically including certain patents, patent applications, trademarks and other intellectual property.

The foregoing descriptions of the amendments to the Note Purchase Agreement are qualified in their entirety by reference to the amendments themselves, copies of which are being filed as exhibits to this report.

### **Fifth Amended and Restated Articles of Incorporation**

On November 24, 2008 the Company filed the Fifth Amended and Restated Articles of Incorporation (the “Fifth Restated Articles”) with the Utah Division of Corporations and Commercial Code. The Fifth Restated Articles have been amended from time to time to extend the mandatory redemption date of the Series B Preferred Stock. Most recently, the Fifth Amendment was filed February 26, 2010, which extended the mandatory redemption date of the Series B Preferred Stock to May 9, 2010, or such later date as agreed to in writing by the holders of at least 80% of the outstanding shares of Series B Preferred Stock.

The foregoing descriptions of the amendments to the Fifth Restated Articles are qualified in their entirety by reference to such amendments, copies of which are being filed as exhibits to this report.

## Item 6. Exhibits

The following exhibits are filed as part of this report:

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
3.1	Fifth Amended and Restated Articles of Incorporation of Groen Brothers Aviation, Inc. filed November 24, 2008 (1)
3.2	First Amendment to Fifth Amended and Restated Articles of Incorporation of Groen Brothers Aviation, Inc. filed March 17, 2009 (1)
3.3	Second Amendment to Fifth Amended and Restated Articles of Incorporation of Groen Brothers Aviation, Inc. filed July 1, 2009 (1)
3.4	Third Amendment to Fifth Amended and Restated Articles of Incorporation of Groen Brothers Aviation, Inc. filed October 5, 2009 (1)
3.6	Fifth Amendment to Fifth Amended and Restated Articles of Incorporation of Groen Brothers Aviation, Inc. filed March 3, 2010 (1)
10.1	Note Purchase Agreement dated as of October 9, 2008 by and among Groen Brothers Aviation, Inc. and Lenders named therein (1)
10.2	Form of Promissory Notes Issued under the Note Purchase Agreement dated as of October 9, 2008 and the schedule of Notes issued to date (1)
10.3	Amended and Restated Security Agreement dated as of January 20, 2009 among the Company and the Lenders under the Note Purchase Agreement (1)
10.4	Amended and Restated IP Security Agreements dated as of October 9, 2008 among the Company and the Lenders under the Note Purchase Agreement (1)
10.5	Form of Promissory Notes Issued under the Note Purchase Agreement dated as of October 9, 2008 in payment of Series B Preferred Stock dividends and the schedule of Notes issued to date (1)
10.6	First Amendment to Promissory Notes between Groen Brothers Aviation, Inc. and the lender named therein dated as of October 9, 2008 with regard to the 2006/2007 Notes (1)
10.7	First Amendment to Promissory Notes between Groen Brothers Aviation, Inc. and the lender named therein dated as of October 9, 2008 with regard to 2007 Notes (1)
10.8	Second Amendment to Promissory Notes between Groen Brothers Aviation, Inc. and the lender named therein dated as of March 2, 2009 with regard to the 2006/2007 Notes*
10.9	Second Amendment to Promissory Notes between Groen Brothers Aviation, Inc. and the lender named therein dated as of March 2, 2009 with regard to 2007 Notes*
10.10	First Amendment to Note Purchase Agreement dated as of March 2, 2009 among Groen Brothers Aviation, Inc., Groen Brothers Aviation USA, Inc. and the lenders named therein*
31.1	Section 302 Certification of Chief Executive and Chief Financial Officer*
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer*

\* Exhibits filed with this report.

(1) Exhibits filed with the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2008 and incorporated herein by reference.

## **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.

GROEN BROTHERS AVIATION, INC.

/s/ David Groen

David Groen, President, Chief Executive Officer  
and Chief Financial Officer  
(Principal Executive and Principal Financial Officer)

Date: April 30, 2010

## RULE 13a-14(a) CERTIFICATION

I, David Groen, certify that:

1. I have reviewed this report on Form 10-Q of Groen Brothers Aviation, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 30, 2010

/s/ David Groen

David Groen

President, Chief Executive Officer and Chief Financial Officer  
(Principal Executive and Principal Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Groen Brothers Aviation, Inc. (the "Company") on Form 10-Q for the period ending March 31, 2009, as filed with the Securities and Exchange Commission (the "Report"), I, David Groen, Chief Executive Officer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ David Groen

\_\_\_\_\_  
David Groen

President, Chief Executive Officer and Chief Financial Officer  
(Principal Executive and Principal Financial Officer)

Date: April 30, 2010