

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

FORM 10-QSB

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

For the quarterly period ended March 31, 2006

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

For the transition period from _____ to _____

Commission file number 018958

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 W. California Avenue
Salt Lake City, Utah
Address of principal executive offices

84104
Zip Code

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

Check 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 is a large accelerated filer, an accelerated filer or non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class
Common Stock, No Par Value

Outstanding at March 31, 2006
147,696,008

Transitional Small Business Disclosure Format. Yes No

GROEN BROTHERS AVIATION, INC.
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PART 1 – FINANCIAL INFORMATION

Item 1. Financial Statements

GROEN BROTHERS AVIATION, INC.
Condensed Consolidated Balance Sheet (Unaudited)
March 31, 2006

Assets

Current assets:

Cash	\$ 5,000
Accounts receivable	771,000
Related party notes receivable	86,000
Prepaid expenses	2,000
Inventories	288,000

Total current assets 1,152,000

Property and equipment, net 435,000

Total assets \$ 1,587,000

Liabilities and Stockholders' Deficit

Current liabilities:

Accounts payable	\$ 1,857,000
Accrued expenses	4,785,000
Deferred revenue	545,000
Short-term notes payable	698,000
Related party notes payable	7,341,000
Series B 15% cumulative redeemable non-voting preferred stock, no par value, 50,000,000 shares authorized, 39,309 shares issued and outstanding	39,309,000
Liability to issue additional shares of Series B 15% preferred stock	3,217,000

Total current liabilities 57,752,000

Long-term liabilities:

Accrued expenses	3,883,000
Deferred revenue	25,000
Long-term debt	292,000
Related party deposits	2,145,000

Total liabilities 64,097,000

Stockholders' deficit:

Series A convertible preferred stock, no par value, 50,000,000 shares authorized, 1,400,000 shares issued and outstanding	70,000
Common stock, no par value, 500,000,000 shares authorized, 147,696,008 shares issued and outstanding	29,027,000
Accumulated deficit	(91,607,000)

Total stockholders' deficit (62,510,000)

Total liabilities and stockholders' deficit \$ 1,587,000

See accompanying notes to condensed consolidated financial statements.

GROEN BROTHERS AVIATION, INC.
Condensed Consolidated Statements of Operations (Unaudited)
Three Months Ended March 31,

	<u>2006</u>	<u>2005</u>
Revenues	\$ 963,000	\$ 237,000
Costs and expenses:		
Cost of sales	1,280,000	299,000
Research and development	746,000	614,000
General and administrative expenses	441,000	517,000
Total costs and expenses	<u>2,467,000</u>	<u>1,430,000</u>
Loss from operations	<u>(1,504,000)</u>	<u>(1,193,000)</u>
Other income (expense):		
Related party interest income	1,000	1,000
Interest and other income	5,000	7,000
Interest expense	(278,000)	(234,000)
Series B preferred stock interest expense	<u>(3,399,000)</u>	<u>(2,110,000)</u>
Total other income (expense)	<u>(3,671,000)</u>	<u>(2,336,000)</u>
Loss before income taxes	(5,175,000)	(3,529,000)
Income tax benefit	<u>-</u>	<u>-</u>
Net loss	<u>\$ (5,175,000)</u>	<u>\$ (3,529,000)</u>
Net loss applicable to common stockholders	<u>\$ (5,175,000)</u>	<u>\$ (3,529,000)</u>
Net loss per share – basic and diluted	<u>\$ (0.04)</u>	<u>\$ (0.03)</u>
Weighted average number of common shares outstanding – basic and diluted	<u>141,656,000</u>	<u>117,365,000</u>

See accompanying notes to condensed consolidated financial statements.

GROEN BROTHERS AVIATION, INC.
Condensed Consolidated Statements of Operations (Unaudited)
Nine Months Ended March 31,

	<u>2006</u>	<u>2005</u>
Revenues	\$ 1,812,000	\$ 597,000
Costs and expenses:		
Cost of sales	2,299,000	712,000
Research and development	1,954,000	1,673,000
General and administrative expenses	1,378,000	1,322,000
Total costs and expenses	<u>5,631,000</u>	<u>3,707,000</u>
Loss from operations	<u>(3,819,000)</u>	<u>(3,110,000)</u>
Other income (expense):		
Related party interest income	4,000	7,000
Interest and other income	169,000	18,000
Interest expense	(1,093,000)	(939,000)
Series B preferred stock interest expense	(10,442,000)	(5,563,000)
Total other income (expense)	<u>(11,362,000)</u>	<u>(6,477,000)</u>
Loss before income taxes	(15,181,000)	(9,587,000)
Income tax benefit	<u>-</u>	<u>-</u>
Net loss	<u>\$ (15,181,000)</u>	<u>\$ (9,587,000)</u>
Net loss applicable to common stockholders	<u>\$ (15,181,000)</u>	<u>\$ (9,587,000)</u>
Net loss per share – basic and diluted	<u>\$ (0.11)</u>	<u>\$ (0.08)</u>
Weighted average number of common shares outstanding – basic and diluted	<u>134,908,000</u>	<u>114,621,000</u>

See accompanying notes to condensed consolidated financial statements.

GROEN BROTHERS AVIATION, INC.
Condensed Consolidated Statements of Cash Flows (Unaudited)
Nine Months Ended March 31,

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Net loss	\$ (15,181,000)	\$ (9,587,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	120,000	89,000
Common stock issued for interest and services expenses	139,000	20,000
Stock options and warrants issued for interest and services expenses	1,092,000	80,000
Interest expense accrued on Series B preferred stock	9,517,000	5,563,000
Interest expense on put option liability	45,000	59,000
Accrued interest expense added to debt principal	-	49,000
Common stock issued for 401(k) expense	124,000	88,000
Gain on settlement of debt	(149,000)	-
Other	(4,000)	2,000
(Increase) decrease in:		
Accounts and notes receivable	(758,000)	(7,000)
Prepaid expense	2,000	-
Inventories	107,000	53,000
Increase (decrease) in:		
Accounts payable	976,000	3,000
Accrued expenses	1,186,000	1,463,000
Deferred revenue	(23,000)	20,000
	(2,807,000)	(2,105,000)
Cash flows from investing activities:		
Purchase of property and equipment	(165,000)	(30,000)
Issuance of related party notes receivable	(29,000)	-
Payments of related party notes receivable	3,000	89,000
	(191,000)	59,000
Cash flows from financing activities:		
Proceeds from the issuance of debt	1,096,000	611,000
Repayment of debt	(297,000)	(53,000)
Proceeds from the issuance of common stock and stock options	2,165,000	1,806,000
Payment of finders' compensation on issuance of common stock	(31,000)	(14,000)
	2,933,000	2,350,000
Net cash provided by financing activities	2,933,000	2,350,000
Net increase (decrease) in cash	(65,000)	304,000
Cash, beginning of period	70,000	27,000
	\$ 5,000	\$ 331,000
Cash, end of period	\$ 5,000	\$ 331,000

See accompanying notes to condensed consolidated financial statements.

GROEN BROTHERS AVIATION, INC.
Notes to Condensed Consolidated Financial Statements
Nine Months Ended March 31, 2006 (Unaudited)

Note 1: Organization and Basis of Presentation

Organization and Consolidation

Effective November 1, 2004, Groen Brothers Aviation, Inc. (the “Company”) merged American Autogyro, Inc. (“AAI”), a wholly owned subsidiary, into Groen Brothers Aviation USA, Inc. (“GBA-USA”), a wholly owned subsidiary. GBA-USA will continue the manufacturing, sales and marketing functions of AAI’s SparrowHawk gyroplane. GBA-USA will be doing business as (d.b.a.) American Autogyro for all of its SparrowHawk operations.

The unaudited condensed consolidated financial statements include the accounts of the Company and subsidiaries and include all adjustments (consisting of normal recurring items) which are, in the opinion of management, necessary to present fairly the financial position as of March 31, 2006, the results of operations for the three months and nine months ended March 31, 2006 and 2005, and cash flows for the nine months ended March 31, 2006 and 2005. The results of operations for the three months and nine months ended March 31, 2006 are not necessarily indicative of the results to be expected for the full fiscal year ending June 30, 2006.

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. The Company’s continuation as a going concern is dependent on attaining profitable operations, obtaining additional outside financing and/or restructuring its debt obligations. The Company has funded losses from operations in the current year primarily from the issuance of debt 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. The Company anticipates that the issuance of debt and the sale of the Company’s restricted common stock will 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 in Note 2, the Company announced on November 7, 2005 that the US Defense Advanced Research Projects Agency (“DARPA”) has selected the Company to lead a team to design a proof of concept high speed, long range, vertical takeoff and landing (“VTOL”) aircraft designed for use in combat search and rescue roles. This contract has been a significant source of revenues for the nine months ended March 31, 2006. The Company believes that its share of revenues from phase one of the contract, currently estimated at approximately \$4.3 million, will continue to be the largest source of revenues in the short term, and will have a positive impact on cash flows from operations. However, the Company will be required to add personnel, expand facilities and make other significant purchases to meet its obligations under this contract, which may result in a low profit margin realized on the DARPA contract.

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Operating revenues from the DARPA contract and from the sale of SparrowHawk kit gyroplanes, the Company's primary source of operating revenues prior to the award of the DARPA contract, are not currently sufficient, nor will they be sufficient in the near future, to cover operating expenses. SparrowHawk kit sales, in particular, will not be sufficient to cover related operating expenses for the following reasons:

- To date, the Company has experienced a negative gross profit on sales because of the start-up and "learning curve" costs that are normally experienced in the introduction of a new product and due to lower than expected sales volume.
- The Company projects that as the Company improves its manufacturing capabilities and increases its sales efforts the negative gross profit on sales will narrow in fiscal year 2007, although there is no assurance that the Company will be successful in reducing the negative gross margin.
- The Company continues to incur significant research and development expenditures related to fully assembled SparrowHawk gyroplane derivatives and to potential applications of the Company's technology to vertical take-off and landing military aircraft, runway independent short-haul airliners and other aircraft.
- Marketing and sales efforts continue, but the number of SparrowHawk kits sold is below expectations, due in part to lack of funding to undertake product development and to pay for increased sales and marketing efforts.

The Company will continue to explore what it expects to be larger, untapped markets for fully assembled SparrowHawk gyroplane aircraft, including law enforcement agencies both in the United States and overseas using the SparrowHawk as a surveillance aircraft. The Company believes the margins on these completed aircraft will be substantially higher than on kit gyroplanes, although there is no assurance that higher margins will be realized. However, through the date of this filing, no sales of fully assembled SparrowHawk gyroplane aircraft to law enforcement agencies have occurred.

The Company does not expect revenues from the sale of Hawk 4 gyroplanes will be realized until the Company completes the Federal Aviation Administration ("FAA") or equivalent international certification of the aircraft. Currently, the Company estimates that approximately \$40 million to \$60 million and a two to three year period will be required to complete the certification. The Company is in discussions with parties that have expressed interest in funding the completion of the certification and commencing the production of the Hawk 4 gyroplane. These discussions are ongoing, but the Company is not in a position to conclude how likely a favorable outcome to these opportunities is. With the announcement of such a funding source, the Company believes prospects will improve to raise equity capital from other sources to fund operations and meet debt obligations. Because of ongoing research and development efforts and the projected costs of certification, the Company does not project that it will have net income or positive cash flows from Hawk 4 operations until FAA certification is obtained and sales of Hawk 4 gyroplanes reach planned levels.

GROEN BROTHERS AVIATION, INC.
Notes to Condensed Consolidated Financial Statements
Nine Months Ended March 31, 2006 (Unaudited)

As a result, the Company anticipates that operating costs of personnel, facilities, research and development and sales and marketing will increase from levels reported for fiscal year 2005 and for the first nine months of fiscal year 2006.

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.

Note 2: DARPA Contract

The Company announced on November 7, 2005 that the US Defense Advanced Research Projects Agency (“DARPA”) has selected the Company to lead a team to design a proof of concept high speed, long range, vertical takeoff and landing (“VTOL”) aircraft designed for use in combat search and rescue roles. Phase One of this potential multi year four phase program begins with a fifteen month \$6.4 million award to develop the preliminary design and perform key technology demonstrations. The Company estimates its share of Phase One payments will approximate \$4.3 million, with the remaining portion to be paid by the Company to subcontractors and consultants hired by the Company. Payments under this contract are conditional upon the Company attaining several milestone objectives during the course of Phase One of the contract. Contracts for subsequent phases are conditional on completion of Phase One and successor phases.

The Company recognizes revenue on this 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 will instruct the Company to submit an invoice for payment for the respective milestone at the amounts specified in the contract. Contract-related expenses incurred by the Company for each milestone of the contract, including its own labor, travel, supplies and other costs, and the costs of subcontractors and consultants, will be deferred and expensed to cost of sales as the contract revenue for the milestone is recognized. During December 2005, the Company completed the first milestone of the DARPA contract and recognized contract revenue of \$390,000. During March 2006, the Company completed the second milestone of the DARPA contract and recognized contract revenue of \$760,000. Total direct costs of the first two milestones of approximately \$1,140,000 were expensed to cost of sales during the nine months ended March 31, 2006.

Note 3: 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

GROEN BROTHERS AVIATION, INC.
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during the period, as well as common shares issuable upon the conversion of debt and preferred stock 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. During the nine months ended March 31, 2006, 400,000 collateral shares were returned to the Company and cancelled when the related debt was repaid. At March 31, 2006, the Company had issued 5,350,000 shares of common stock as collateral.

Note 4: Reclassifications

Certain amounts in the financial statements for the three months and nine months ended March 31, 2005 have been reclassified to conform to the current period presentation.

Note 5: Stock Based Compensation

For stock options granted to employees, the Company utilizes the footnote disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123 encourages entities to adopt a fair-value based method of accounting for stock options or similar equity instruments. However, it also allows an entity to continue measuring compensation cost for stock-based compensation using the intrinsic-value method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. The Company has elected to continue to apply the provisions of APB 25 and provide pro forma footnote disclosures required by SFAS No. 123 as applicable. Accordingly, no compensation cost has been recognized in the condensed consolidated financial statements for stock options granted to employees. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date consistent with the provisions of SFAS No. 123, the Company's net loss and loss per share would have been as indicated below:

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Notes to Condensed Consolidated Financial Statements
Nine Months Ended March 31, 2006 (Unaudited)

	Three Months Ended March 31,	
	2006	2005
Reported net loss applicable to common stockholders	\$ (5,175,000)	\$ (3,529,000)
Deduct: Total stock-based employee compensation determined under fair value based method, net of related tax effects	(274,000)	(88,000)
Pro forma net loss	\$ (5,449,000)	\$ (3,617,000)
Basic and diluted loss per share:		
As reported	\$ (0.04)	\$ (0.03)
Pro forma	\$ (0.04)	\$ (0.03)

	Nine Months Ended March 31,	
	2006	2005
Reported net loss applicable to common stockholders	\$ (15,181,000)	\$ (9,587,000)
Deduct: Total stock-based employee compensation determined under fair value based method, net of related tax effects	(1,239,000)	(1,200,000)
Pro forma net loss	\$ (16,420,000)	\$ (10,787,000)
Basic and diluted loss per share:		
As reported	\$ (0.11)	\$ (0.08)
Pro forma	\$ (0.12)	\$ (0.09)

Note 6: Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Financial Accounting Standard (“FAS”) No. 123(R), *Share-Based Payment*, an amendment of FASB Statements No. 123 and 95. FAS No. 123(R) replaces FAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. This statement requires companies to recognize the fair value of stock options and other stock-based compensation to employees prospectively beginning with fiscal periods beginning after June 15, 2005 (December 15, 2005 for small business issuers), however, the Securities and Exchange Commission has deferred this date for public companies. The new rule allows companies to implement FAS No. 123(R) at the beginning of their next fiscal year. This means

GROEN BROTHERS AVIATION, INC.
Notes to Condensed Consolidated Financial Statements
Nine Months Ended March 31, 2006 (Unaudited)

that the Company will be required to implement FAS No. 123(R) no later than the quarter beginning July 1, 2006. The Company currently measures stock-based compensation in accordance with APB Opinion No. 25, as discussed above. The Company anticipates adopting the modified prospective method of FAS No. 123(R) on July 1, 2006. The impact on the Company's financial condition or results of operations will depend on the number and terms of stock options outstanding on the date of change, as well as future options that may be granted. However, the Company believes the adoption of FAS No. 123(R) may have a material effect on the Company's financial position and results of operations.

The FASB has issued FAS Statement No. 154, *Accounting Changes and Error Corrections*. This new standard replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. Among other changes, Statement 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. Statement 154 also provides that (1) a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a "restatement." The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The Company anticipates adopting FAS No. 154 on January 1, 2006, and does not believe the adoption of this new accounting pronouncement will result in a material impact on the Company's financial condition or results of operations.

Note 7: Inventories:

Inventories consisted of the following at March 31, 2006:

Raw materials and parts	\$	193,000
Work-in-process		95,000
		95,000
Total	\$	288,000

Note 8: Accrued Expenses:

Accrued expenses reported as current liabilities consisted of the following at March 31, 2006:

GROEN BROTHERS AVIATION, INC.
Notes to Condensed Consolidated Financial Statements
Nine Months Ended March 31, 2006 (Unaudited)

Related party interest	\$ 3,495,000
Compensation, related taxes and benefits	588,000
Interest	471,000
Consulting fees	99,000
Finders' compensation	42,000
Royalties to related parties	18,000
Other	<u>72,000</u>
Total	<u><u>\$ 4,785,000</u></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 of 1% of the gross sales price of gyroplanes are to be paid to the Company's founders, David and Jay Groen. Through March 31, 2006, royalties payable totaled \$9,000 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 December 31, 2005:

Deferred compensation	\$ 3,417,000
Accrued payroll taxes on deferred compensation	144,000
Accrued interest on deferred compensation	<u>322,000</u>
Total	<u><u>\$ 3,883,000</u></u>

The deferred compensation is payable to twelve officers and directors 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, 2006, 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, 2006 as the Company does not anticipate payment of any of these amounts in the next twelve months.

GROEN BROTHERS AVIATION, INC.
Notes to Condensed Consolidated Financial Statements
Nine Months Ended March 31, 2006 (Unaudited)

Note 9: Debt

Included in short-term notes payable at March 31, 2006 are notes payable to vendors and others totaling \$649,000, substantially all of which are technically in default. The Company continues ongoing negotiations with 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 and long-term debt at March 31, 2006 are payable to stockholders of the Company who are considered related parties. The Company is also delinquent in making payments on capital lease obligations of \$660,000 and other notes payable totaling \$1,270,000 included in related party notes payable.

The Company is also delinquent on making payments of accrued interest payable on debt of \$789,000, of which \$362,000 is payable to related parties.

Note 10: Put Option Liability

During the year ended June 30, 2004, the Company and a stockholder entered into an Amendment to the Common Stock Purchase Agreement Dated November 7, 2000 whereby the Company extended the dates to which the stockholder could exercise a put option and the Company could exercise the option to redeem, and increased both the put prices and the optional redemption prices. As a result, the stockholder had the right to put up to 750,000 shares of common stock of the Company, exercisable on November 7, 2005 or at any time during the three years ending on November 7, 2008. The put price could be paid by the Company in cash or in registered, unrestricted, freely tradable common shares of the Company at \$2.08 per share prior to May 7, 2006, \$2.16 per share between May 7 and November 6, 2006, \$2.25 per share between November 7, 2006 and May 6, 2007, \$2.33 per share between May 7 and November 6, 2007, \$2.41 per share between November 7, 2007 and May 6, 2008, and \$2.50 per share between May 7 and November 7, 2008.

At its option, the Company could have redeemed up to 750,000 shares of common stock of the Company at any time from December 15, 2003 through November 7, 2005. The redemption price was payable in cash at \$1.72 per share prior to May 7, 2004, \$1.84 per share between May 7 and November 6, 2004, \$1.96 per share between November 7, 2004 and May 6, 2005, and \$2.08 per share between May 7 and November 7, 2005. The Company's option to redeem the 750,000 shares expired on November 7, 2005.

The Company used the Black-Scholes option pricing model to periodically reassess the fair value of the put option liability to determine if the carrying value of the liability in the consolidated financial statements required adjustment, with the adjustment recorded as an increase or decrease to interest expense.

In November 2005, the shareholder put the 750,000 shares to the Company. The Company did not have the cash or the ability to issue shares of registered, unrestricted common

GROEN BROTHERS AVIATION, INC.
Notes to Condensed Consolidated Financial Statements
Nine Months Ended March 31, 2006 (Unaudited)

stock of the Company. However, the shareholder agreed to accept 5,004,009 unregistered, restricted shares of the Company's common stock in satisfaction of the put option liability of \$1,560,000, or approximately \$0.31 per share.

Note 11: Related Party Deposits

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. As stockholders of the Company, the dealers 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 12: Preferred Stock

Series B 15% Preferred Stock

At March 31, 2006, the Company had 39,309 shares of Series B 15% Preferred Stock outstanding with a recorded value of \$39,309,000.

On October 11, 2005, the holders of the Series B 15% Preferred Stock ("Series B Holders") extended the redemption date of the Series B 15% Preferred Stock from October 31, 2005 to January 1, 2007. The Company amended its Articles of Incorporation on October 11, 2005 to reflect the modification to the redemption date. The Series B 15% Preferred Stock has been reported as a current liability in the condensed consolidated balance sheet as of March 31, 2006.

The October 11, 2005 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.

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- The issuance of additional shares of Series B 15% 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.

In connection with the extension of the redemption date of the original issuance of the Company's Series B 15% Preferred Stock and the sale of 8,000 shares of the Series B 15% Preferred Stock during the second quarter of fiscal year 2004, the Company's Articles of Incorporation were amended to require that all redemptions of the Series B 15% Preferred Stock be paid in cash.

The Articles of Incorporation have been further amended to define the maturity date as the first to occur of (a) January 1, 2007, (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. In addition, the amended Articles of Incorporation require pro rata redemptions of the Series B 15% Preferred Stock with the proceeds of certain financing transactions that exceed \$20 million in the aggregate. As a result, if the Company is successful in raising the levels of funding that it requires to bring its obligations current and fund its planned operations, significant portions of this funding will be required to make redemption payments on the Series B 15% Preferred Stock in advance of the January 1, 2007 maturity date.

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 15% Preferred Stock on October 14, 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 value of the net additional warrants issued in October 2005 and charged to interest expense was \$924,000. The Series B 15% Preferred Stock will be classified through its redemption as a troubled debt restructuring.

Included in the periodic interest expense on the Series B 15% Preferred Stock is the accretion of the \$10,700,000 obligation to issue 10,700 shares of additional Series B 15% Preferred Stock on January 1, 2007, calculated on the interest method. The cumulative accretion of this obligation is recorded as a current liability of \$3,217,000 in the Company's condensed consolidated balance sheet as of March 31, 2006.

Series A Convertible Preferred Stock

Voting control by one of the Company's founders, David Groen, had existed from November 7, 2000 by means of shares of Series A Preferred Stock issued to him in exchange for

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a note receivable. The note receivable matured in November 2003, and Mr. Groen surrendered all Series A Preferred Stock in cancellation of the note. The Board of Directors and management of the Company believed that the continuity of voting control by one or both of the founders of the Company was crucial to the ongoing operations and growth of the Company.

On October 8, 2004, the Company amended and restated its Articles of Incorporation to change the rights and terms of its Series A Convertible Preferred Stock. On October 8, 2004, the Board of Directors approved the issuance of 1,400,000 shares of Series A Convertible Preferred Stock to the Company's founders: 900,000 shares to David Groen, President and Chief Executive Officer, and 500,000 shares to Jay Groen, Chairman of the Board of Directors, at a purchase price of \$0.05 per share, or total consideration of \$70,000. The amended rights, terms and preferences of the Series A Convertible Preferred Stock 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 between the then existing members of the Company's Board of Directors on a pro-rata basis, based upon the number of months they have served on the Board, with the holder's survivor(s) (if more than one person, treated collectively as one person) being included in the same pro-rata basis, crediting the survivor's "months served" as those of the deceased or permanently mentally incapacitated holder. 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.

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The value of \$.05 per share was assigned to the Series A Preferred Stock by the Company's Board of Directors after evaluating several factors, including those listed above relating to limitations on the transferability of the shares, the limited life of the voting rights, the significant revenue milestones to be met before conversion to common stock can occur, and the absence of dividend or liquidation rights.

Note 13: Stockholders' Equity

During the nine months ended March 31, 2006, the Company issued a total of 18,421,836 shares of its restricted common stock, primarily to accredited investors in transactions exempt from registration. These shares were issued at prices ranging from \$0.20 to \$0.35 per share through private placement offerings in reliance upon the exemption from registration contained in Rule 506 of Regulation D. The shares were issued for the following consideration: 9,874,417 shares for cash of \$2,121,000; 632,302 shares in payment of accrued expenses of \$131,000; 94,907 shares in reduction of deferred revenue of \$19,000; 280,357 shares in payment of services of \$57,000; 1,221,213 shares in reduction of debt of \$249,000; 398,558 shares in payment of interest expense of \$82,000; 405,093 shares to acquire property and equipment of \$81,000, 5,000 shares in payment of a customer refund of \$1,000, 5,004,009 shares in payment of a put option liability of \$1,560,000; and 505,980 shares in payment of the Company's 401(k) plan contribution. In addition, cash finders' compensation and accrued finders' compensation on the sale of common stock totaled \$31,000 and \$98,000, respectively, during the nine month period. The Company did not use underwriters in the sale or placement of these unregistered shares of common stock.

The Company has generally placed a value per share on non-cash transactions equal to recent cash prices per share where shares of the Company's restricted common stock have been issued in payment of goods and services, reduction of debt and other purposes. The Company believes, based on the many cash sales of the Company's restricted common stock during the nine months ended March 31, 2006, ranging from \$0.20 to \$0.35 per share, that these values per share are appropriate to use for issuances of restricted common shares in non-cash transactions. These per share values also approximated the quoted market prices of the Company's common stock during the nine-month period.

During the nine months ended March 31, 2006, the Company issued options to purchase a total of 20,760,408 shares of common stock: 16,007,000 options to investors in connection with the sale of common stock of the Company with exercise prices of \$0.20 to \$0.25 per share exercisable for periods of 1 to 2 years; 1,528,408 options as a loan origination fee or interest to a lenders with exercise prices of \$0.20 to \$0.25 per share exercisable for a period of 1 to 3 years; 1,000,000 options to a vendor for services with an exercise price of \$0.50 per share exercisable for a period of three years; and 2,225,000 options to employees with an exercise price of \$0.25 per share exercisable for a period of 5 to 7 years (granted under the Company's employee stock option plan for which a Form S-8 registration statement has been filed). The Company estimated the value of the 1,528,408 options issued to the lenders at \$104,000 using the Black-Scholes option pricing model, and charged this amount to interest expense. The Company estimated the value of the 1,000,000 options issued to a vendor for services at \$30,000 using the Black-Scholes

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option pricing model, and charged this amount to general and administrative expense. The Company also issued options to purchase a total of 1,000,000 shares of common stock for cash of \$44,000, with an exercise price of \$0.20 per share for a period of one year. In addition, the Company recorded interest expense of \$29,000 on 3,200,000 variable stock options during the six months ended December 31, 2005 using the Black-Scholes option pricing model.

The Company cancelled warrants to purchase 2.5 million shares of the Company's common stock at \$0.30 per share issued to the Series B Holders and issued the Series B Holders 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 Company recorded interest expense estimated at \$924,000 using the Black-Scholes option pricing model during the nine months ended March 31, 2006 attributable to the net additional warrants issued.

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. During the nine months ended March 31, 2006, 400,000 collateral shares were returned to the Company and cancelled when the related debt was repaid. At March 31, 2006, the Company had issued 5,350,000 shares of common stock as collateral.

As discussed in Note 10, the Company acquired 750,000 shares of its common stock when a shareholder exercised a put option. These shares were subsequently cancelled.

Note 14: Supplemental Statement of Cash Flows Information

During the nine months ended March 31, 2006, the Company:

- Decreased related party notes receivable through reduction of accrued expenses payable to related parties of \$12,000.
- Decreased accounts receivable and increased related party notes receivable by \$20,000.
- Issued 405,093 shares of common stock to acquire property and equipment of \$81,000.
- Decreased accounts payable and increased short-term notes payable by \$61,000.
- Issued 632,302 shares of common stock in payment of accrued expenses of \$131,000.
- Increased accrued expenses and decreased common stock by \$98,000 for accrued finders' compensation.

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- Issued 94,907 shares of common stock in reduction of deferred revenue of \$19,000.
- Issued 5,000 shares of common stock in payment of a customer refund of \$1,000.
- Issued 1,221,213 shares of common stock in payment of debt of \$249,000.
- Issued 5,004,009 shares of common stock in payment of put option liability of \$1,560,000.
- Issued 398,558 shares of common stock in payment of interest expense of \$82,000.
- Issued 280,357 shares of common stock for services of \$57,000.
- Issued 505,980 shares of common stock in payment of the Company's 401(k) plan contribution.
- Issued debt of \$13,000 to purchase property and equipment.

During the nine months ended March 31, 2005, the Company:

- Decreased related party notes receivable through reduction of accrued expenses payable to related parties of \$20,000.
- Issued 240,000 shares of common stock in payment of accounts payable of \$48,000.
- Issued 278,875 shares of common stock in payment of accrued expenses of \$53,000.
- Issued 65,109 shares of common stock in payment of interest expense of \$13,000.
- Issued 66,375 shares of common stock in return of deposits of \$13,000.
- Issued 100,000 shares of common stock for prepaid consulting services of \$20,000.
- Issued notes payable to acquire property and equipment of \$7,000.
- Issued a note payable in return of deferred revenue of \$28,000.
- Increased accrued expenses and decreased common stock by \$84,000 for accrued finders compensation.
- Issued 1,400,000 shares of Series A preferred stock for a decrease in accrued expenses of \$70,000.

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- Converted \$40,000 of related party notes payable and \$27,000 of accrued interest payable into 67 shares of Series B preferred stock.
- Paid finders compensation with 5,750 shares of common stock.

Cash paid for interest expense was \$83,000 and \$59,000 for the nine months ended March 31, 2006 and 2005, respectively.

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

This management's discussion and analysis of financial condition and results of operations and other portions of this Quarterly Report on Form 10-QSB 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-KSB for the year ended June 30, 2005, filed on October 14, 2005, under the heading "Forward Outlook and Risks" and elsewhere. Investors should review this quarterly report on Form 10-QSB in combination with our Annual Report on Form 10-KSB 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.

Background

The Company has developed proprietary technology that promises significant advances for rotary-winged aircraft. The initial objective of the Company was to develop and market an easy-to-fly and cost-efficient gyroplane that could compete effectively in the general aviation market.

Effective July 1, 1993 and continuing through March 31, 2003, the Company was considered a development stage company as defined in SFAS No. 7. The Company's development stage activities consisted primarily of the development and preparation for FAA certification of the Hawk 4 gyroplane. Sources of financing for these development stage activities were primarily debt and equity financing.

During the first quarter of fiscal year 2003, the Company suspended its flight testing of the Hawk 4 at its Buckeye facility in Arizona due to the lack of sufficient financial resources necessary to complete commercial certification. Further development toward commercial certification of the Hawk 4 has been deferred pending the receipt of required funding. The Company's business plan for the Hawk 4 is now oriented toward offering this aircraft in its already well tested form to the US government, and to governments of friendly countries. This would give the Company the opportunity to receive revenues ahead of FAA certification, and as a result, to reduce the need for funding to permit the start of production of the Hawk 4. The Company is confident that the safety, reliability, maneuverability and low operating cost of the Hawk 4 will permit it to perform competitively with helicopters (and airplanes) for many missions requiring low, slow flight, but without the requirement for a runway for take-off or landing. The

Company is currently in discussions with foreign investors relating to potential funding of Hawk 4 certification, although there is no assurance that the Company will be successful in obtaining such funding.

The Company has received significant deposits on aircraft from the Company's authorized dealers in anticipation of full-scale production of the Hawk 4. These dealer deposits are recorded as a long-term liability in the Company's consolidated balance sheet.

From 2003 onward through March 31, 2006, the Company's operating focus has been directed to the final development of the two-seat piston engine powered SparrowHawk, which it has designed and now manufactures and sells through its American Autogyro arm. Through March 31, 2006, 22 American Autogyro dealerships have been established in the United States and 8 internationally. In addition, the Company developed and continues to sell modification kits designed to improve in-flight stability and safety for another manufacturer's kit gyroplane. In December 2005, the Company announced the introduction of its improved SparrowHawk model, the SparrowHawk II. SparrowHawk II offers improved performance, added comfort and robustness, and greatly eases the effort, and reduces the time, needed by the customer to build the aircraft. All aircraft now being delivered are manufactured to the SparrowHawk II standard.

While the initial market for the SparrowHawk lies with builders of home-built aircraft from kits, management believes that there are larger, untapped markets for fully assembled small gyroplanes. An emerging market for such aircraft is arising within the United States as a result of the Federal Aviation Administration (FAA) definition of a new category of aircraft, namely the Light Sport Aircraft (LSA). The Company has therefore initiated the design of a new light gyroplane, called the SportHawk that would meet the LSA regulations and has applied for an exemption applicable to gyroplanes. This would allow the Company to participate initially in the LSA category through a sub-classification called Experimental Light Sport Aircraft (E-LSA).

A variation of the LSA design, called the ShadowHawk, is also being developed that incorporates additional capabilities that are expected to enable this model to be a very attractive, low cost patrol aircraft for law enforcement agencies, both in the United States and overseas, and have other manned and unmanned applications.

The Company began deliveries of SparrowHawk kits during the third quarter of its fiscal year ended June 30, 2004, recording initial revenues from this aircraft in the fourth quarter of fiscal year 2004. Through March 31, 2006, 84 initial orders for SparrowHawk gyroplane kits have been received, with 58 complete kits delivered. In the same period, 29 orders for the stabilization modification kits were ordered, with 28 kits delivered. During the nine months ended March 31, 2006, the Company reported SparrowHawk sales revenues of \$515,000 on 17 delivered kits, upgrades and parts and 2 stabilization modification kits. The Company has received substantial advance payments from dealers and customers on SparrowHawk gyroplane kit orders during the past several quarters, which have been recorded as deferred revenue. Additional revenues have also been received from the sale of modification kits, flight training and from contract manufacturing; however, these revenue sources have not been, and are not projected to be, significant to the Company.

On November 7, 2005, the Company announced that the U.S. Defense Advanced Research Projects Agency ("DARPA") had selected a Company-led team to design a proof of concept high-speed, long range, vertical takeoff and landing ("VTOL") aircraft. This modern rotorcraft, named the "Heliplane" by DARPA, is intended for use in combat search and rescue roles. It will offer the VTOL capability of a helicopter, the fast forward flight of an airplane, and the safety, simplicity and reliability of a GBA gyroplane and is designed to exploit the Company's gyrodyne technology. DARPA is the central

research and development organization for the US Department of Defense (DoD). It manages and directs select basic and applied research for DoD, emphasizing technology development projects where payoff is high and where success may provide dramatic advances in the capabilities of this country's combat forces.

Phase One of this potential multi-year \$40 million four-phase program begins with a fifteen month \$6.4 million award to develop the preliminary design and perform key technology demonstrations. The Company estimates its share of Phase One payments will approximate \$4.3 million, with the remaining portion to be paid by the Company to subcontractors and consultants hired by the Company. Payments under this contract are conditional upon the Company attaining several milestone objectives during the course of Phase One of the contract. Contracts for subsequent phases are conditional on completion of Phase One and successor phases.

During December 2005, the Company completed the first milestone of the DARPA Heliplane contract and recognized contract revenue of \$390,000. During March 2006, the Company completed the second milestone of the DARPA contract and recognized contract revenue of \$760,000. Total direct costs of the first two milestones of approximately \$1,140,000 were expensed to cost of sales during the nine months ended March 31, 2006.

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 the Company's gyrodyne technology is scalable to much larger aircraft, it has potential applications for both heavy lift, high speed VTOL military aircraft and for runway independent commercial airliners. The Company has 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 and China with respect to commercial gyroplane applications.

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. The Company's continuation as a going concern is dependent on attaining profitable operations, obtaining additional outside financing and/or restructuring its debt obligations. The Company has funded losses from operations in the current year primarily from the issuance of debt 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. The Company anticipates that the issuance of debt and the sale of the Company's restricted common stock will 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.

The DARPA contract has been a significant source of revenues for the nine months ended March 31, 2006. The Company believes that its share of revenues from phase one of the contract, currently estimated at approximately \$4.3 million, will continue to be the largest source of revenues in the short term, and will have a positive impact on cash flows from operations. However, the Company will be required to add personnel, expand facilities and make other significant purchases to meet its obligations under this contract, which may result in a low profit margin realized on the DARPA contract.

Operating revenues from the DARPA contract and from the sale of SparrowHawk kit gyroplanes, the Company's primary source of operating revenues prior to the award of the DARPA contract, are not

currently sufficient, nor will they be sufficient in the near future, to cover operating expenses. SparrowHawk kit sales, in particular, will not be sufficient to cover related operating expenses for the following reasons:

- To date, the Company has experienced a negative gross profit on sales because of the start-up and “learning curve” costs that are normally experienced in the introduction of a new product and due to lower than expected sales volume.
- The Company projects that as the Company improves its manufacturing capabilities and increases its sales efforts the negative gross profit on sales will narrow in fiscal year 2007, although there is no assurance that the Company will be successful in reducing the negative gross margin.
- The Company continues to incur significant research and development expenditures related to fully assembled SparrowHawk gyroplane derivatives and to potential applications of the Company’s technology to vertical take-off and landing military aircraft, runway independent short-haul airliners and other aircraft.
- Marketing and sales efforts continue, but the number of SparrowHawk kits sold is below expectations, due in part to lack of funding to undertake product development and to pay for increased sales and marketing efforts.

The Company will continue to explore what it expects to be larger, untapped markets for fully assembled small gyroplane aircraft, including law enforcement agencies both in the United States and overseas for use as a surveillance aircraft. The Company believes the margins on these completed aircraft will be substantially higher than on kit gyroplanes, although there is no assurance that higher margins will be realized. However, through the date of this filing, no sales of fully assembled SparrowHawk gyroplane aircraft to law enforcement agencies have occurred.

The Company does not expect revenues from the sale of Hawk 4 gyroplanes will be realized until the Company completes the Federal Aviation Administration (“FAA”) or equivalent international certification of the aircraft. Currently, the Company estimates that approximately \$40 million to \$60 million and a two to three year period will be required to complete the certification. The Company is in discussions with parties that have expressed interest in funding the completion of the certification and commencing the production of the Hawk 4 gyroplane. These discussions are ongoing, but the Company is not in a position to conclude how likely a favorable outcome to these opportunities is. In addition, with the announcement of such a funding source, the Company believes prospects will improve to raise equity capital from other sources to fund operations and meet debt obligations. Because of ongoing research and development efforts and the projected costs of certification, the Company does not project that it will have net income or positive cash flows from Hawk 4 operations until FAA certification is obtained and sales of Hawk 4 gyroplanes reach planned levels.

As a result, the Company anticipates that operating costs of personnel, facilities, research and development and sales and marketing will increase from levels reported for fiscal year 2005 and for the first nine months of fiscal year 2006.

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.

Results of Operations

Revenues

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
Government contract	\$ 760,000	\$ -	\$ 1,150,000	\$ -
SparrowHawk kits and parts	165,000	209,000	585,000	509,000
Modification kits	6,000	11,000	11,000	42,000
Flight training	19,000	17,000	52,000	46,000
Other operating	13,000	-	14,000	-
Total	\$ 963,000	\$ 237,000	\$ 1,812,000	\$ 597,000

Total revenues increased to \$963,000 in the three months ended March 31, 2006 from \$237,000 in the three months ended March 31, 2005. The increase in revenues in the three months ended March 31, 2006 was primarily attributed to the completion of milestone 2 of the DARPA contract and recognition of government contract revenue of \$760,000 in March 2006. The Company had no government contracts in the three months ended March 31, 2005. During the three months ended March 31, 2006, the Company reported revenues of \$165,000 from the sale of 5 SparrowHawk kits, options and parts, compared to \$209,000 from the sale of 7 SparrowHawk kits, options and parts during the three months ended March 31, 2005.

Total revenues increased to \$1,812,000 in the nine months ended March 31, 2006 from \$597,000 in the nine months ended March 31, 2005. Again, the increase in revenues in the nine months ended March 31, 2006 was primarily attributed to the completion of milestones 1 and 2 of the DARPA contract and recognition of government contract revenue of \$390,000 in December 2005 and \$760,000 in March 2006. The Company had no government contracts in the nine months ended March 31, 2005. During the nine months ended March 31, 2006, the Company reported revenues of \$585,000 from the sale of 17 SparrowHawk kits, options and parts, compared to \$509,000 from the sale of 18 SparrowHawk kits, options and parts.

At March 31, 2006, advance deposits recorded as deferred revenue and collected over the past several quarters of \$545,000 from customers and dealers principally for SparrowHawk kits, have contributed to operating cash flow. During fiscal year 2006, the Company will be progressively increasing its focus on satisfying a growing demand for SparrowHawk kits, and, to a lesser extent, for modification kits. The Company recognizes revenues on the sale of SparrowHawk kits when a complete kit has been delivered and the collection of the remaining purchase price is reasonably assured. While less in dollar amount, flight training revenue will be an ongoing addition to Company cash flow.

The Company recognizes 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 the Company to submit an invoice for payment for the respective milestone at the amount specified in the contract.

Costs and Expenses

Comparing the three months ended March 31, 2006 to the three months ended March 31, 2005, cost of sales increased to \$1,280,000 from \$299,000. The increase in the current year period was primarily due to the cost of sales recorded for the DARPA contract of \$858,000 and the cost of sales of the SparrowHawk kits, options and parts of \$395,000. Comparing the nine months ended March 31, 2006 to the nine months ended March 31, 2005, cost of sales increased to \$2,299,000 from \$712,000, primarily due to the cost of sales recorded for the DARPA contract of \$1,140,000 and the cost of sales of the SparrowHawk kits, options and parts of \$1,068,000. The Company did not have any government contracts during the fiscal year ended June 30, 2005.

The Company continues to experience a negative gross profit on the SparrowHawk kits because of the nonrecurring and “learning curve” costs that are normally experienced in the introductory production of a new product and due to lower than expected sales volume. Ongoing improvements to the design and packaging of the kits without a similar increase in the sales price of the kits, and the transition of substantial portions of kit manufacturing and assembly operations to the Salt Lake City facility also contributed to increasing negative margins on the sale of SparrowHawk kits. The Company anticipates that as the Company improves its manufacturing capabilities and increases its sales efforts, the negative gross profit on sales will narrow in fiscal year 2007, but may not turn positive. In addition, only nominal gross margin is realized on the sale of modification kits and on flight training. All costs of incomplete SparrowHawk kits delivered as of March 31, 2006 have been deferred and included in work-in-process inventories.

Comparing the three months ended March 31, 2006 to the three months ended March 31, 2005, research and development expenses increased to \$746,000 from \$614,000. Comparing the nine months ended March 31, 2006 to the nine months ended March 31, 2005, research and development expenses increased to \$1,954,000 from \$1,673,000. The increase in research and development expenses on a year-to-date basis in the current fiscal year is due primarily to the addition of new engineering employees in relation to the development of applications for contracts from government agencies, including the DARPA contract, and to increases in compensation for current employees. Research and development activities have also consisted of ongoing variations to the SparrowHawk, fully assembled SparrowHawk gyroplane derivatives, potential applications of the Company’s technology to heavy lift vertical take-off military aircraft, runway independent short-haul airliners and other aircraft, including government contract opportunities.

Comparing the three months ended March 31, 2006 to the three months ended March 31, 2005, general and administrative expenses decreased to \$441,000 from \$517,000. Comparing the nine months ended March 31, 2006 to the nine months ended March 31, 2005, general and administrative expenses increased to \$1,378,000 from \$1,322,000. The increase on a year-to-date basis in the current year is due primarily to the addition of personnel and to increases in compensation for current personnel supporting the sales and development of the SparrowHawk and government contract opportunities, offset by an increase in the overhead allocation to the DARPA contract, which is included in cost of sales.

Other Income and Expenses

Comparing the three months ended March 31, 2006 to the three months ended March 31, 2005, related party interest income remained at \$1,000. Comparing the nine months ended March 31, 2006 to the nine months ended March 31, 2005, related party interest decreased to \$4,000 from \$7,000 due to repayment of certain related party note receivable in the current fiscal year.

Comparing the three months ended March 31, 2006 to the three months ended March 31, 2005, interest and other income decreased to \$5,000 from \$7,000. Comparing the nine months ended March 31, 2006 to the nine months ended March 31, 2005, interest and other income increased to \$166,000 from \$18,000 primarily because of a \$149,000 gain on settlement of debt recognized in the current year second quarter. In addition to the gain on settlement of debt, interest and other income is comprised of interest income earned on the Company's bank deposits, sales of scrap materials and other miscellaneous sources.

Interest expense for the three months ended March 31, 2006 compared to the three months ended March 31, 2005 increased to \$278,000 from \$234,000. Comparing the nine months ended March 31, 2006 to the nine months ended March 31, 2005, interest expense increased to \$1,093,000 from \$939,000. The increase in the current fiscal year was due primarily to additional interest expense incurred in the current fiscal year on the issuance of stock options to lenders in connection with new debt or debt extensions, and the effect of current fiscal year net additions to debt.

Comparing the three months ended March 31, 2006 to the three months ended March 31, 2005, Series B Preferred Stock interest expense increased to \$3,399,000 from \$2,110,000. Compared to the nine months ended March 31, 2006 to the nine months ended March 31, 2005, Series B Preferred Stock interest expense increased to \$10,442,000 from \$5,563,000. 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. As a result, the number of shares on which the interest expense is computed has continued to increase. In addition, the \$925,000 estimated value of the additional warrants issued in connection with the extension of the due date of the Series B Preferred Stock in October 2005 was charged to Series B Preferred Stock interest expense. This interest expense in the three months ended March 31, 2006 and the three months December 31, 2005 was also increased by \$1,978,000 and \$1,239,000, respectively for the accretion of the future obligation to issue additional shares of Series B Preferred Stock on January 1, 2007, the extended maturity date.

Net Loss

During the three months and nine months ended March 31, 2006, the Company continued to record losses as it progressed toward full marketing and manufacturing of the SparrowHawk gyroplane kit, continued research and development activities on SparrowHawk gyroplane derivatives and other applications of the Company's gyroplane technology, and continued work on the DARPA contract. For the three months ended March 31, 2006, the loss from operations was \$1,504,000 compared to the loss from operations of \$1,193,000 for the three months ended March 31, 2005. For the nine months ended March 31, 2006, the loss from operations was \$3,819,000 compared to \$3,110,000 for the nine months ended March 31, 2005. The increase in the loss from operations in the current fiscal year resulted from negative gross margins on revenues and increases in operating costs and expenses as described above, offset by the increase in revenues.

The net loss and the net loss applicable to common stockholders for the three months ended March 31, 2006 was \$5,175,000 compared to \$3,529,000 for the three months ended March 31, 2005. The net loss and the net loss applicable to common stockholders for the nine months ended March 31, 2006 was \$15,181,000 compared to \$9,587,000 for the nine months ended March 31, 2005. The increase in the net loss and the net loss applicable to common stockholders in the current fiscal year resulted from increases in operating costs and expenses and Series B Preferred Stock interest expense, as described above, offset by the increase in revenues.

Liquidity and Capital Resources

At March 31, 2006, the Company had total current liabilities of \$57,752,000 and current assets of \$1,152,000, resulting in a working capital deficiency of \$56,600,000. Included in current liabilities and the working capital deficiency at March 31, 2006 is a total of \$42,526,000 in Series B Preferred Stock obligations that are payable on January 1, 2007. Total liabilities exceed total assets by \$62,510,000 at March 31, 2006. The Company anticipates that operating costs of personnel, facilities, research and development and sales and marketing will increase from levels reported for fiscal year 2005 and for the first nine months of fiscal year 2006.

Net cash used in operating activities was \$2,807,000 for the nine months ended March 31, 2006 compared to \$2,105,000 for the nine months ended March 31, 2005, primarily due to negative gross margins on revenues and increases in operating costs and expenses as described above.

The Company has funded losses from operations in the current fiscal year and historically primarily from the issuance of debt 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.

Net cash used in investing activities for the nine months ended March 31, 2006 was \$191,000, comprised of the purchase of property and equipment of \$165,000 and the issuance of related party notes receivable of \$29,000, offset by related party notes receivable repayments of \$3,000. Net cash provided by investing activities for the nine months ended March 31, 2005 was \$59,000 comprised of related party notes receivable repayments of \$89,000, offset by the purchase of property and equipment of \$30,000.

Net cash provided by financing activities was \$2,933,000 for the nine months ended March 31, 2006, comprised of a net increase in debt of \$799,000 and net proceeds from the issuance of common stock of \$2,134,000. Net cash provided by financing activities for the nine months ended March 31, 2005 was \$2,350,000, comprised of a net increase in debt of \$558,000 and net proceeds from the issuance of common stock of \$1,792,000. The Company anticipates that the issuance of debt and the sale of the Company's restricted common stock will 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. The Company believes that its share of revenues from the DARPA contract, which are payable only upon the Company attaining several milestone objectives, will have a positive impact on cash flows from operations; however, the Company will also be required to add personnel, expand facilities and make other significant purchases to meet its obligations under this contract. There is no assurance that the Company will be successful in either raising sufficient capital or improving operations.

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

Following the economic downturn of 9/11 and its impact on the aerospace industry, the Company's fund-raising activities in the venture capital market were seriously impaired, resulting in active development of its Hawk 4 gyroplane for commercial certification being deferred. The Company, however, continues to actively seek sales and funding for government and public use applications of the Hawk 4 as well as for the SparrowHawk.

In the face of continuing fund-raising difficulties, in fiscal years 2002 and 2003, the Company successfully approached many of its principal vendors requesting that they accept extensions of payments beyond their normal terms. As a result, the Company is servicing much of its pre-November 2001

obligations to vendors utilizing a combination of repayment plans, which include monthly payments for smaller vendor liabilities and promissory notes for larger vendor liabilities. As of March 31, 2006, the Company was delinquent in making payments on substantially all promissory notes to vendors and to other unrelated party lenders, which totaled \$649,000. The Company continues ongoing negotiations with these vendors and lenders, and has, in most instances, been granted grace periods and extensions without receipt of formal notices of default or threat of legal action. The Company intends to repay in full all vendors and lenders, including accrued interest where applicable. The Company is also delinquent in making payments on capital lease obligations to a related party of \$660,000, other related party notes payable totaling \$1,270,000, and accrued interest payable on debt of \$789,000.

On October 11, 2005, the holders of the Series B 15% Preferred Stock (“Series B Holders”) extended the redemption date of the Series B 15% Preferred Stock from October 31, 2005 to January 1, 2007. The Company amended its Articles of Incorporation on October 11, 2005 to reflect the modification to the redemption date. The Series B 15% Preferred Stock has been reported as a current liability of \$39,309,000 in the consolidated balance sheet as of March 31, 2006 because of the pending redemption date of January 1, 2007.

The October 11, 2005 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 15% 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.

The cumulative accretion of the obligation to issue additional shares of Series B Preferred Stock is also recorded as a current liability of \$3,217,000 in the Company’s condensed consolidated balance sheet as of March 31, 2006.

In connection with the extension of the redemption date of the original issuance of the Company’s Series B 15% Preferred Stock and the sale of 8,000 shares of the Series B 15% Preferred Stock during the second quarter of fiscal year 2004, the Company’s Articles of Incorporation were amended to require that all redemptions of the Series B 15% Preferred Stock be paid in cash.

The Articles of Incorporation have been further amended to define the maturity date as the first to occur of (a) January 1, 2007, (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. In addition, the amended Articles of Incorporation require pro rata redemptions of the Series B 15% Preferred Stock with the proceeds of certain financing transactions that exceed \$20 million in the aggregate. As a result, if the Company is successful in raising the levels of funding that it requires to bring its obligations current and fund its planned operations, significant portions of this funding will be required to make redemption payments on the Series B 15% Preferred Stock in advance of the January 1, 2007 maturity date.

The projected total obligation of the Series B 15% Preferred Stock at January 1, 2007, the current maturity date, including the \$10.7 million obligation for the new shares, is approximately \$54.6 million. In to repay this obligation 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 an extension as it has accomplished in the past. There is no assurance that the Company will be successful in these endeavors.

Critical Accounting Policies

The Company's critical accounting policies include the following:

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 - The Company recognizes 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 the Company has no significant obligations remaining. Portions of the purchase price of the Company's 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.

The Company recognizes revenue on its 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 the Company to submit an invoice for payment for the respective milestone at the amount specified in the contract. Contract-related expenses incurred by the Company for each milestone of the contract, including its own labor, travel, supplies and other costs, and the costs of subcontractors and consultants, are deferred and expensed to cost of sales as the contract revenue for the milestone is recognized.

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 the Company's Series B 15% Preferred Stock and a put option obligation as liabilities. The carrying value of the Series B 15% Preferred Stock was the same before and after adoption of SFAS No. 150, and therefore no cumulative effect adjustment was required.

Put Option Liability - To comply with SFAS No. 150, the Company estimated the fair value of the put option liability using the Black-Scholes option-pricing model. Until the obligation was satisfied in November 2005, the Company used this methodology to periodically reassess the fair value of the put option liability to determine if the carrying value of the liability in the consolidated financial statements

required adjustment, with changes in the fair value recognized as interest cost. The fair value of the put option liability was inversely related to the fair value of the Company's common stock. Any material changes in the fair value of the Company's common stock could have resulted in material changes in the fair value of the put option liability.

Non-Employee Stock Options and Warrants – In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation", the Company estimates 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, the Company 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 the Company's 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.

Recently Issued Accounting Principles

In December 2004, the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standard ("FAS") No. 123(R), *Share-Based Payment*, an amendment of FASB Statements No. 123 and 95. FAS No. 123(R) replaces FAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. This statement requires companies to recognize the fair value of stock options and other stock-based compensation to employees prospectively beginning with the first interim or annual period of the first fiscal year beginning after December 15, 2005 for small business issuers, as deferred by the Securities and Exchange Commission. This means that the Company will be required to implement FAS No. 123(R) no later than the quarter beginning July 1, 2006. The Company currently measures stock-based compensation in accordance with APB Opinion No. 25, as discussed above. The Company anticipates adopting the modified prospective method of FAS No. 123(R) on July 1, 2006. The impact on the Company's financial condition or results of operations will depend on the number and terms of stock options outstanding on the date of change, as well as future options that may be granted. However, the Company believes the adoption of FAS No. 123(R) may have a material effect on the Company's financial position and results of operations.

The FASB has issued FAS Statement No. 154, *Accounting Changes and Error Corrections*. This new standard replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. Among other changes, Statement 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. Statement 154 also provides that (1) a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a "restatement." The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The Company anticipates adopting FAS No. 154 on January 1, 2006, and does not believe the adoption of this new accounting pronouncement will result in a material impact on the Company's financial condition or results of operations.

Item 3. Controls and Procedures

(A) Evaluation of disclosure controls and procedures

The Company's Chief Executive Officer and Chief Financial Officer have conducted an evaluation of the Company's disclosure controls and procedures as of March 31, 2006. Based on their evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded, for the reasons described below, that the Company's disclosure controls and procedures were not effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the applicable Securities and Exchange Commission rules and forms.

During the audit of the Company's consolidated financial statements for the year ended June 30, 2005, management and the Company's independent auditors identified a material weakness in the Company's internal control over the financial reporting process relating to the identification, recording and reporting of cost of sales of the Company's products, the cost of raw materials and parts inventories, and the cost of work-in-process inventories through the Company's manufacturing and cost accounting software. In addition, the Company has not completely implemented the accounting module of this ERP software to enable the costs of the Company's purchasing, manufacturing and sales activities to integrate with the financial statements of the Company.

During the first nine months of fiscal year 2006, the Company has been implementing the following actions to address the cost accounting weakness described above. The Company purchased an upgrade to the ERP system and has committed to fully implement the accounting module of the software. Training has been conducted for finance and other personnel of the Company in the use of the ERP software, and such training will continue during fiscal year 2006. Consultants from the vendor of the software have visited the Company and provided a report recommending improvements and providing instructions for fully integrating all modules of the software which the Company is using in its plans to strengthen controls. The Company has also hired a cost accountant experienced in a manufacturing environment similar to that of the Company. The Company believes that it will require four to six months to implement the changes necessary to fully address the cost accounting weakness, and currently estimates the accounting module of the ERP software will be fully implemented in the first or second quarter of fiscal year 2007.

Management has also determined that a weakness in internal controls over financial reporting exists due to an overall lack of segregation of duties resulting from the limited number of personnel in the Company's accounting department. The Company's independent auditors have classified this weakness as a reportable condition. Management believes that as the Company expands with increased sales activities and government contract opportunities, additional accounting personnel will be added, resulting in improved ability to segregate key accounting and financial reporting duties.

In connection with the audit of the Company's consolidated financial statements for the year ended June 30, 2004, management and the Company's independent auditors identified certain material weaknesses in the Company's internal control over the financial reporting process pertaining to the timely evaluation and recording of transactions related to the Company's Series B 15% Preferred Stock and the Company's put option liability. The Company recorded adjusting entries in the fourth quarter of its fiscal year ended June 30, 2004 to correct errors in the second and third quarters of fiscal year 2004 related to these financial statement items. Subsequently, the Company restated the condensed consolidated statements of operations for the quarterly periods in fiscal year 2004 included for comparison purposes in its quarterly reports on Form 10-QSB for fiscal year 2005 to reflect the correcting entries in the appropriate interim periods of the prior fiscal year.

During fiscal year 2005 and continuing into fiscal year 2006, the Company implemented changes to improve its internal controls over financial reporting. These changes included, among other procedures, more comprehensive documentation of accounting policies and procedures, implementation of analytical review procedures, schedules and checklists for the preparation of interim and annual financial statements, and executive level review of journal entries.

(B) Changes in internal controls

Other than the matters discussed above, there were no other significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the most recent evaluation of these controls by the Company's Chief Executive Officer and Chief Financial Officer.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There have been no material developments during the three months ended March 31, 2006 in the legal proceedings disclosed in the Company's previously-filed periodic reports.

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

During the three months ended March 31, 2006 the Company issued a total of 1,890,405 shares of its restricted common stock, primarily to accredited investors in transactions exempt from registration. These shares were issued at prices ranging from \$0.20 to \$0.25 per share through private placement offerings in reliance upon the exemption from registration contained in Rule 506 of Regulation D. The shares were issued for the following consideration: 842,250 shares for cash of \$173,000; 96,300 shares in payment of accrued expenses of \$20,000; 167,500 shares in payment of services of \$34,000; 75,000 shares in reduction of debt of \$15,000; 203,375 shares in payment of interest expense of \$41,000; and 505,980 shares in payment of the Company's 401(k) plan contribution. In addition, accrued finders' compensation on the sale of common stock totaled \$5,000 during this period. The Company did not use underwriters in the sale or placement of these unregistered shares of common stock.

During the three months ended March 31, 2006, the Company issued options to purchase a total of 767,250 shares of its restricted common stock to investors in connection with the sale of common stock of the Company with exercise prices of \$0.20 to \$0.25 per share exercisable for a period of one year.

Item 3. Defaults Upon Senior Securities

The Company is current on its obligations pertaining to the Series B 15% Cumulative Redeemable Non-Voting Preferred Stock. However, as more fully discussed under "Liquidity and Capital Resources" above, the Company is delinquent in making payments on notes payable to vendors totaling \$649,000, capital lease obligations of \$660,000, notes payable to related parties totaling \$1,270,000, and \$789,000 of accrued interest payable on debt.

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

No matters were submitted to a vote of security holders during the quarter ended March 31, 2006.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits (filed with this report unless indicated below):

- | | |
|------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 11 | Statement re: computation of per share earnings (included in Note 3 to the Condensed Consolidated Financial Statements). |
| 31.1 | Certification of principal executive officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of principal financial officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of principal executive officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of principal financial officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GROEN BROTHERS AVIATION, INC.

By: /s/ David Groen
David Groen, President and Chief Executive Officer
(Principal Executive Officer)

Date: May 19, 2006

By: /s/ Dennis P. Gauger
Dennis P. Gauger, Chief Financial Officer and Secretary
(Principal Financial and Accounting Officer)

Date: May 19, 2006

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO RULE 13a - 14(a) OF THE
SECURITIES EXCHANGE ACT OF 1934, AS AMENDED,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, David Groen certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB of Groen Brothers Aviation, Inc. for the quarter ended March 31, 2006.

2. Based on my knowledge, this quarterly 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 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)) 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) 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

c) 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 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.

/s/ David Groen

David Groen, President and Chief Executive Officer
(Principal Executive Officer)
May 19, 2006

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO RULE 13a - 14(a) OF THE
SECURITIES EXCHANGE ACT OF 1934, AS AMENDED,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Dennis P. Gauger certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB of Groen Brothers Aviation, Inc. for the quarter ended March 31, 2006.

2. Based on my knowledge, this quarterly 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 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)) 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) 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

c) 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 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.

/s/ Dennis P. Gauger

Dennis P. Gauger, Chief Financial Officer and Secretary
(Principal Accounting Officer)

May 19, 2006

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

In connection with the Quarterly Report of Groen Brothers Aviation, Inc. (the "Company") on Form 10-QSB for the quarter ended March 31, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), I, David Groen, President and Chief Executive Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- a. the Quarterly Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
- b. the information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ David Groen
David Groen, President and Chief Executive Officer
(Principal Executive Officer)
May 19, 2006

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

In connection with the Quarterly Report of Groen Brothers Aviation, Inc. (the "Company") on Form 10-QSB for the quarter ended March 31, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), I, Dennis P. Gauger, Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- a. the Quarterly Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
- b. the information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Dennis P. Gauger
Dennis P. Gauger, Chief Financial Officer and Secretary
(Principal Accounting Officer)
May 19, 2006